PHILIPPINES BOX 95 FILE 6 1986
Memos August - Dec

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my file.

Office Memorandum

TO: Mr. Narvekar
Mr. Neiss

December 17, 1986

FROM: Anoop Singh AS

SUBJECT: Philippines: Paris Meetings

Attached are the statements prepared in December for the Paris Club and the Consultative Group. They were seen by Management (no comments were made). If the meetings are rescheduled for January, I believe that they will continue to be relevant, barring exceptional developments. (On the latter point, we are concerned about movements in reserve money and have addressed a message to Mr. Karlik to alert the authorities and to give us greater information.)

The next meeting week of the Paris Club is January 19-23 and it is likely that the Philippines will be rescheduled for that time (proposed January 22/23). Assuming I would still go to the meeting, I would plan to return to Washington from India before going to Paris. There is greater doubt about the timing of the Consultative Group. It could be later in January, or in early February, in Tokyo or Bangkok. (The Paris office schedule appears to be full for late January).

gs6phcgl PHC 11-26-86

Consultative Group Meeting for the Philippines
December 11-12, 1986
Statement of the IMF Representative

Mr. Chairman, you will agree that this has been a watershed year for the Philippines. From our different perspectives, we have watched the events unfold and have, with admiration, counted the many achievements. The timing of this meeting of the full Consultative Group, coming as it does at the close of 1986, provides a convenient opportunity to take stock of recent events and assess the medium-term prospects for the Philippine economy.

For our part, we engaged in discussions on economic policy with the new administration soon after its assumption of office and, over the subsequent months, were privileged to help as their new economic priorities were crystallized into a bold and consistent economic strategy. The priorities embodied in this strategy represent a decisive shift away from the systems of economic management that prevailed over many previous years. Embodied in it is far more than just a scheme for a recovery from the debilitating depression of recent years that is an early imperative of the authorities. The strategy has a comprehensiveness designed to address the specific structural distortions that have, in the past, shackled private sector activity and exports, distorted prices and margins, and favored inefficient industries and vested interests. As these long standing weaknesses of the economy are tackled, it is hoped that investor confidence will be gradually restored and, with it, the economy's potential for sustained growth over the medium term would also return.

There are four broad principles of the strategy: (1) a substantial reduction in government intervention in the economy; (2) the reestablishment of competitive markets on the basis of an appropriate set of incentives; (3) renewed emphasis on rural development and on the equitable sharing of the benefits of a sustained recovery; and (4) a more competitive and outward looking economy through trade liberalization and flexible exchange rate policies. Mr. Chairman, in my remarks today, I will first make reference to the policy actions in various sectors that have already been taken to implement this strategy and, subsequently, refer to the critical elements that will help shape the success of the strategy.

At the heart of the program is the intended reform of the public sector, its efficiency, its institutions, and its claims on resources. Over recent months, the authorities have introduced a tax reform package that should improve incentives for investment and exports, reduce the scope and the motivation for evasion and, by strengthening the elasticity of the tax system, contribute to a narrowing of public sector deficits in future years. This will demand a sustained effort to improve tax and expenditure administration. World Bank staff have been working closely with the authorities to reorient public expenditures toward the rural and labor-intensive projects that are high among the government's economic priorities. Beyond this, the authorities intend, as part of the economic program, to carry out far-reaching institutional reforms in the public financial and nonfinancial corporations so as to reduce the burden they impose on the national government budget. This process is, as the World Bank will confirm, at an advanced stage for the public financial sector, and we look forward to the incorporation of specific measures for the non-financial sector at the time of the first review of the Fund program scheduled for early 1987. As all these structural actions take hold, it is expected that there will be a gradual decline in the financing requirement of the consolidated public sector over the medium term.

External sector reforms are an equal part of the process aimed at shifting the structure of incentives in favor of exports and a more efficient import substitution. You are aware that during the consolidation period of recent years, following the financial crisis of October 1983, there was a sharp improvement in the external current account. However, this improvement was secured primarily through a large drop in imports while export performance remained weak. This is not a trend that can, for long, be perpetuated. A strong export growth is essential to support a sustained economic recovery as well as contribute to a lasting restoration of balance of payments viability. Consequently, an outward-looking strategy is necessary for the succes of the program, and, to this end, some crucial first steps have already been taken, including the dismantling of important import and export monopolies and successive rounds of import liberalization. These efforts, while an important early manifestation of the importance attached to an environment more conducive to the recovery of exports, by no means exhaust the scope available. Further progress in import liberalization, in tariff reform, and in export diversification will be essential if the external objectives of the medium term outlook are to be achieved. The maintenance of a competitive exchange rate is also an essential part of the process.

These constitute the essential areas of emphasis under the program. There are others, in particular, the important supporting role that financial policies must play in accomodating a recovery without rekindling inflationary expectations or straining the external position. A deliberate and sharp recovery in public investment is targeted during 1986-87, to initiate a revival of growth during a period when private investment and activity is expected to rebound only gradually with the return of confidence. The program with the Fund expects a reduction of this limited fiscal stimulus, as the tax reform and the rationalization of public corporations take hold, and as the private sector is able to participate more fully in the recovery.

Mr. Chairman, there is no doubt that the success of the strategy will be measured by nothing less than a return to sustained growth. At the same time, we must recognize that it will take some time for the fruits of the policy adjustments, in terms of improved economic performance, to be fully realized. Also, that important preconditions that nuture confidence must first be created. Delays in creating these conditions will also delay sparking the recovery. It is important that, in this interim period, there continues to be a steadiness in and continued commitment to the unfolding of the strategy. It will be imperative that the momentum of structural reforms proceed boldly, both in the evolution of necessary new policies as well as in their implementation.

Mr. Chairman, we have projected external current account deficits in the range of 2-3 percent of GNP during the medium-term period on the basis of a sharp rebound in non-oil imports and a modest export recovery. In considering the financing requirement for this period, we have assumed the need to maintain official gross reserves at 3-3.5 months of imports of goods and services. We have assumed that a large proportion of the financing need is met by spontaneous actions that result in an accelerated utilization of the existing pipeline and annual additions to this pipeline by normal multilateral and bilateral commitments. Other aspects of financing, involving the rescheduling payments to private and official creditors, are being discussed separately in different forums. However, even with the most optimistic scenarios, the Philippine debt service ratio over this period is unlikely to fall under 30 percent, demonstrating its continued need for the goodwill and support of this group.

PHC--gs61125ph2--11/26/86

Statement by the IMF Representative at the Meeting of Creditor Countries of the Philippines in Paris, December 15, 1986

Background

During 1984-86, the Philippine economy underwent substantial adjustment of the external and internal imbalances that emerged forcefully in 1983, culminating in the requests for rescheduling and concerted financial packages with private and official creditors. Externally, the current deficit which had reached 8 percent of GNP in 1983 was eliminated as were payments arrears, and there was a gradual restoration of the country's gross reserve position. The inflationary environment that had been created with the onset of the external crisis in 1983 was reversed. However, these achievements were tempered by the unanticipated large drop in exports and real activity that was also experienced in this period, a consequence of important weaknesses in the implementation of policies, a continuing lack of investor confidence, and an unfavorable world environment for major Philippine exports.

Developments during the first quarter of 1986 threatened to erode the stabilization successes of the preceding two years when financial policies turned sharply expansionary. However, with the change of government and policies and some early return of confidence, the impact of these financial developments was contained. Thus, inflation has remained firmly under control and external reserves have remained at relatively comfortable levels. Nevertheless, the economy has remained depressed and export performance sluggish.

The new economic strategy

Soon after its assumption of office, the government focused on the development of an economic strategy that has now been formalized into a comprehensive economic program that was supported by a new stand-by arrangement with the Fund, approved on October 24. The new arrangement is for 18 months and is for an amount equivalent to SDR 198 million; at the same time, a purchase of SDR 224.1 million under the compensatory financing decision was also approved. The main objective of this program is to initiate an early recovery of investment and activity which would be sustained in subsequent years without straining financial and external stability.

The broad principles of the strategy are: (i) to reduce substantially government intervention in the economy; (ii) to re-establish competitive markets based on an incentive structure oriented toward the traded goods sector; and (iii) to place renewed emphasis on rural activity that would ensure an equitable sharing of the benefits of a recovery.

Many important policy initiatives have been launched toward applying these principles and creating the framework for a recovery. These include:

1. A major tax reform which is intended as the first step of a comprehensive reform of the public sector. Such a comprehensive reform would also include a re-orientation of the public investment program and a restructuring of the public financial and nonfinancial sectors. As these structural actions are put in place during the program period, it

is expected that they will contribute to a sustained decline in the financial claims of the public sector.

2. Domestic policy initiatives aimed at re-establishing competitive influences in important markets, such as those for sugar and coconuts as well as for some food crops and fertilizer. With these initiatives, the monopoly elements that characterized the production and trade of these commodities have effectively been abolished.

3. External sector reforms that are an equal part of the process aimed at shifting the structure of incentives in favor of exports and a more efficient import substitution. In addition to the dismantling of important import and export monopolies, there have been successive rounds of import liberalization that are an early manifestation of the emphasis in the program toward an outward looking strategy.

Under the program, agreement has also been reached on the important supporting role that financial policies must play in accommodating a recovery without rekindling inflation. Thus, the program anticipates that a deliberate and sharp increase in public investment and, correspondingly, in the public deficit will lead the recovery. This stance of the public sector is to be substantially reversed beginning in 1987, as the tax reform and other structural changes in the public sector take hold, and as the private sector is able to participate more fully in the recovery.

External financing

The medium term balance of payments projections anticipate a gradually rising current deficit, as non-oil imports rebound with the expected recovery, but one that will remain well within 3 percent of GNP. We will review these projections periodically, taking into account their sensitivity to changes in the external economic environment and, especially, the level of international interest rates and world commodity prices. Under favorable conditions of a recovery and a helpful external environment, the Philippines has the potential to move gradually toward a normalization of its balance of payments position, in contrast to the crisis management of recent years. However, a rescheduling of debt service obligations during the next several years will be an essential part of this process.

The cumulative current account deficit for 1987-88 is estimated at $1 billion. Allowing for the maintenance of gross official reserves at around 3.5 months of imports of goods and services and expected capital account financing through a sharp recovery in official (including multilateral) flows, the financing gap for the two-year period is estimated at $3.2 billion, of which $1.3 billion applies to 1987. To cover this financing gap, and with the support of the IMF and the World Bank working in close collaboration, the authorities have requested: (i) a rescheduling of some part of their debt service payments to the Paris Club due after January 1, 1987; and (ii) the further rescheduling of principal payments to foreign commercial banks. There is no request for a concerted new money package from the banks for 1987.

In our view, the bold new policy actions underlying the economic program deserve the broad support of the international financial community as an essential element in the orderly implementation of economic adjustment.

Office Memorandum

SECRET

December 4, 1986

MEMORANDUM FOR FILES

Subject: Mr. Karlik's Memorandum to Minister Ongpin of December 4, 1986

Mr. Karlik has copied to us a memorandum that he has addressed to Minister Ongpin with today's date. It is an unnecessary and somewhat unfortunately worded memorandum.

The first bracketed portion is speculative and should not have been conveyed to the Minister. I had made it clear to Mr. Karlik, in a prior telephone call, in response to his question, that all we can say is that Mr. Narvekar has been able to convey to Fund Management the views of the authorities regarding a resumption of negotiations with the Advisory Group. Beyond that, I had told Mr. Karlik, nothing more could be said.

The second bracketed portion is simply inaccurate and there was no compulsion for Mr. Karlik to convey the thought to the Minister. Since the Advisory Group does not know what terms would be acceptable to the authorities, they could not agree on them at the December 11 meeting.

The third bracketed portion is unfortunate because it conveys in written form a message alternative to the one sent by us yesterday. There was no need to have sent in written form an interpretation of the message from Headquarters, because of the risk that signals would be crossed. (Fortunately, Minister Ongpin's message to Minister Romulo--also attached--is evidence that no damage has been done.) My telephone communication to Mr. Karlik stopped where the bracketed portion begins in the second paragraph of Mr. Karlik's memorandum.

I have conveyed my dissatisfaction on these points to Mr. Karlik. I have instructed him that, in future, memoranda addressed to Ministerial authorities should be cleared, at least orally, with us before they are sent.

AS

Anoop Singh

cc: Mr. Narvekar
Mr. Neiss

DECLASSIFIED

By Anoop Singh Date 1-29-09

Office Memorandum

December 4, 1986

To : Minister Jaime V. Ongpin

From : John Karlik

JK

Subject : Restructuring Debts to Commercial Banks and PSBR Adjustment

Following our conversation this morning, I telephoned Mr. Singh. He confirmed that Mr. Narvekar has been in contact with the Managing Director to convey the current thinking of the Philippine authorities regarding terms for the pending restructuring of debts to commercial banks. Mr. Singh could not say, however, whether the MD had been in touch with the Bank Advisory Group, [although this has probably occurred] or more particularly, what the content of any exchange may have been. As you know, the Bank Advisory Group is meeting December 11, and if the banks among themselves can agree [on terms that are acceptable to the Philippine authorities,] you will be notified soon thereafter. Since the thinking of the Fund has already been transmitted to the Advisory Group, Mr. Singh was also not sure whether any Fund staff observer would attend the December 11 meeting.

With regard to the downward adjustment in the PSBR ceiling in the event that government capital outlays do not meet the P 14.7 billion target, Mr. Singh suggested that I re-emphasize my statement to you this morning that because the decision is for the Executive Board, Fund staff can make no commitment, [but provided all other performance criteria are satsified, the staff would be disposed in February to have an open mind.]

cc: Mr. Singh

Delivered - 12/4/86

Republic of the Philippines
Ministry of Finance
Manila

December 4, 1986

MEMORANDUM

To : Minister A. G. Romulo

From : J. V. ONGPIN

Subject : Adjustment to 1986 PSBR Ceiling

The enclosed memo (replying to my telex of November 20 enclosed) from Hubert Neiss of the IMF was delivered personally by John Karlik to me this morning.

I discussed the contents of the memo with Mr. Karlik and clarified that in view of the projected revenue shortfall, we should proceed on our own discretion to effect budgetary cuts which we consider appropriate and request for a waiver if necessary during the first program review in late February 1987.

The IMF staff has no authority on its own to authorize a waiver at this time since a waiver would require IMF Board approval.

JAIME V. ONGPIN
Minister

Encls.
JVO:edr
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Office Memorandum

N

TO: Mr. Narvekar
Mr. Tait

December 18, 1986

FROM: Ved Gandhi VPG and David Goldsbrough DG

SUBJECT: Philippines: Executive Order Withdrawing all Tax and Duty Incentives

We have received a copy of the Executive Order withdrawing tax and duty privileges that was signed by President Aquino on December 17 (Attachment I). The text of the Order differs substantially from an initial draft provided to us in July (Attachment II) and contains some clauses that may substantially weaken its effectiveness. These clauses provide broad scope for the Fiscal Incentives Review Board to restore any tax or duty exemptions to government or private entities (see Section 1 and Section 2, Page 3 of Attachment I). Consequently, there could be a repetition of the events of 1984, when a large-scale restoration of previously-withdrawn tax and duty privileges took place as a result of political pressure. The Order also refers to the possibility of explicit subsidies for private entities (as well as public corporations) to replace any tax privileges that are withdrawn. There is also a provision for a combination of tax privileges and explicit subsidies under Section 2 (e).

Issuance of all the Executive Orders implementing the tax reform package is also a prior condition for proceeding with the World Bank's Economic Recovery Loan (ERL). We met this morning with Messrs. Ramadan and Hicks of the World Bank together with Mr. Fabella, who is leading the negotiations on the ERL for the Philippine authorities. The Bank staff have similar reservations to our own on the Executive Order, but they do not appear willing to allow negotiations to stall on this point. They would prefer to make some reference, in their loan documents, to this issue being reviewed by the Fund at the time of the First Review of the standby. We indicated that we could not comment on this proposal without further consultation, but noted that the Executive Order, as issued, was clearly not in the spirit of the agreed tax reform package.

In our view, we should now express our reservations on the Executive Order formally both to the Philippine authorities and to the World Bank staff.

cc: Mr. Neiss (o/r)
Mr. Brau
Mr. Singh (o/r)
Mrs. Gurgen

ATTACHMENT I

MALACAÑANG
Manila

EXECUTIVE ORDER NO. 93

WITHDRAWING ALL TAX AND DUTY INCENTIVES, SUBJECT TO CERTAIN EXCEPTIONS, EXPANDING THE POWERS OF THE FISCAL INCENTIVES REVIEW BOARD AND FOR OTHER PURPOSES

WHEREAS, Presidential Decree Nos. 1931 and 1955 issued on June 11, 1984 and October 14, 1984, respectively, withdrew the tax and duty exemption privileges, including the preferential tax treatment, of government and private entities with certain exceptions, in order that the requirements of national economic development, in terms of fiscal and other resources, may be met more adequately;

WHEREAS, both issuances provided for a review by the Fiscal Incentives Review Board (FIRB) of petitions initiated by affected entities for restoration of withdrawn tax and duty exemption privileges either on a total or partial basis;

WHEREAS, a number of affected entities, government and private were able to get back their tax and duty exemption privileges through the review mechanism implemented by the Fiscal Incentives Review Board (FIRB);

WHEREAS, in addition to those whose tax and duty exemption privileges were restored by the Fiscal Incentives Review Board (FIRB), a number of affected entities, government and private, had their tax and duty exemption privileges restored or granted by Presidential action without benefit of review by the Fiscal Incentives Review Board (FIRB);

WHEREAS, the continued enjoyment of these tax and duty exemption privileges has resulted in serious tax base erosion and considerable distortions in the tax treatment of similarly situated entities;

WHEREAS, these privileges have become convenient opportunities for tax manipulation or avoidance, especially in case of interrelated entities;

JA

WHEREAS, the availability of such privileges makes more difficult the attainment of the overall program for national economic development, considering government's fiscal exigencies;

WHEREAS, private entities whose tax and duty exemption privileges are to be withdrawn may still remain competitive by improving on their operational capacity and competence, rather than by relying on fiscal incentives which create distortions in the overall pricing and market systems;

WHEREAS, assistance to government and private entities may be better provided where necessary by explicit subsidy and budgetary support rather than tax and duty exemption privileges if only to improve the fiscal monitoring aspects of government operations; ?

NOW, THEREFORE, I, CORAZON C. AQUINO, President of the Philippines, do hereby order:

SECTION 1. The provisions of any general or special law to the contrary notwithstanding, all tax and duty incentives granted to government and private entities are hereby withdrawn, except:

a) those covered by the non-impairment clause of the Constitution;

b) those conferred by effective international agreements to which the Government of the Republic of the Philippines is a signatory;

c) those enjoyed by enterprises registered with:

(i) the Board of Investments pursuant to Presidential Decree No. 1789, as amended;

(ii) the Export Processing Zone Authority, pursuant to Presidential Decree No. 66, as amended;

(iii) the Philippine Veterans Investment Development Corporation Industrial Authority pursuant to Presidential Decree No. 538, as amended;

d) those enjoyed by the copper mining industry pursuant to the provisions of Letter of Instruction No. 1416;

JA

e) those conferred under the four basic codes namely:

(i) the Tariff and Customs Code, as amended;

(ii) the National Internal Revenue Code, as amended;

(iii) the Local Tax Code, as amended;

(iv) the Real Property Tax Code, as amended;

f) those approved by the President upon the recommendation of the Fiscal Incentives Review Board. ?

SECTION 2. The Fiscal Incentives Review Board created under Presidential Decree No. 776, as amended, is hereby authorized to:

a) restore tax and/or duty exemptions withdrawn hereunder in whole or in part; ?

b) revise the scope and coverage of tax and/or duty exemption that may be restored;

c) impose conditions for the restoration of tax and/or duty exemption;

d) prescribe the date or period of effectivity of the restoration of tax and/or duty exemption;

e) formulate and submit to the President for approval, a complete system for the grant of subsidies to deserving beneficiaries, in lieu of or in combination with the restoration of tax and duty exemptions or preferential treatment in taxation, indicating the source of funding therefor, eligible beneficiaries and the terms and conditions for the grant thereof taking into consideration the international commitments of the Philippines and the necessary precautions such that the grant of subsidies does not become the basis for countervailing action. ?

JH

SECTION 3. In the discharge of its authority hereunder, the Fiscal Incentives Review Board shall take into account any or all of the following considerations:

a) the effect on relative price levels;

b) relative contribution of the beneficiary to the revenue generation effort;

c) nature of the activity the beneficiary is engaged; and

d) in general, the greater national interest to be served.

SECTION 4. The Ministry of Finance shall promulgate the necessary rules and regulations and shall establish and maintain a Secretariat for the Fiscal Incentives Review Board to effectively implement the provisions of this Executive Order.

SECTION 5. All laws, orders, issuances, rules and regulations or parts thereof inconsistent with this Executive Order are hereby repealed or modified accordingly.

SECTION 6. This Executive Order shall take effect upon the promulgation of the rules and regulations stated in Section 4.

Done in the City of Manila, this 17th day of December in the year of Our Lord, nineteen hundred and eighty-six.

Corazon C. Aquino

By the President:

JOKER P. ARROYO
Executive Secretary

ATTACHMENT II.

MALACAÑANG

Manila

EXECUTIVE ORDER NO. ________

WITHDRAWING ALL TAX AND DUTY INCENTIVES AND REPLACING THEM WHERE NECESSARY BY EXPLICIT SUBSIDY AND BUDGETARY SUPPORT, AND FOR OTHER PURPOSES

WHEREAS, Presidential Decree Nos. 1931 and 1955 issued on June 11, 1984 and October 15, 1984, respectively, withdrew the tax and duty exemption privileges, including the preferential tax treatment, of government and private entities, with certain exceptions, in order that the requirements of national economic development, in terms of fiscal and other resources, may be met more adequately;

WHEREAS, both issuances provided for a review by the Fiscal Incentives Review Board (FIRB) of petitions initiated by affected entities for restoration of withdrawn tax and duty exemption privileges either on a total or partial basis;

WHEREAS, a number of affected entities, government and private were able to get back their tax and duty exemption privileges through the review mechanism implemented by the FIRB;

WHEREAS, in addition to those whose tax and duty exemption privileges were restored by the FIRB, a number of affected entities, government and private, had their tax and duty exemption privileges restored or granted by Presidential action without benefit of review by the FIRB;

WHEREAS, the continued enjoyment of these tax and duty exemption privileges has resulted in serious tax base erosion and considerable distortions in the tax treatment of similarly situated entities;

WHEREAS, these privileges have become convenient opportunities for tax manipulation or avoidance, especially in case of interrelated entities;

WHEREAS, the availability of such privileges makes more difficult the attainment of the overall program for national economic development, considering government's fiscal exigencies;

WHEREAS, private entities whose tax and duty exemption privileges are to be withdrawn may still remain competitive by improving on their operational capacity and competence, rather than by relying on fiscal incentives which create distortions in the overall pricing and market systems;

WHEREAS, assistance to government and private entities may be better provided where necessary by explicit subsidy and budgetary support rather than tax and duty exemption privileges if only to improve the fiscal monitoring aspects of government operations;

NOW, THEREFORE, I, CORAZON C. AQUINO, President of the Philippines, by virtue of the powers vested in me by law, do hereby order as follows:

SECTION 1. The provisions of any general or special law to the contrary notwithstanding, all tax and duty incentives granted to government and private entities are hereby withdrawn, except tax and duty exemptions arising out of international agreements to which the Philippines is a signatory;

SECTION 2. The Fiscal Incentives Review Board created under Presidential Decree No. 776 is hereby authorized to review all provisions of tax and duty incentives affected by this Executive Order to determine the extent to which the withdrawn incentives should be replaced by explicit subsidy or budgetary support in order to achieve fiscal policy consistency and efficiency.

SECTION 3. The Ministry of Finance shall promulgate the necessary rules and regulations to effectively implement the provisions of this Executive Order.

SECTION 4. All other laws, decrees, executive orders, administrative orders, rules, regulations and other issuances or parts thereof which are inconsistent with this Executive Order are hereby repealed or modified accordingly.

SECTION 5. This Executive Order shall take effect immediately.

DONE in the City of Manila, this _____ day of July, in the Year of Our Lord, Nineteen Hundred and Eighty-Six.

CORAZON C. AQUINO
President of the Philippines

By the President:

JOKER P. ARROYO
Executive Secretary

N / S

MT

Office Memorandum

TO: Mr. Narvekar December 18, 1986

FROM: ~~David~~ DG Goldsbrough

SUBJECT: Philippines: Withdrawal of Tax and Duty Exemptions

As a follow-up to the memorandum of earlier today by Mr. Gandhi and myself, I attach drafts of memoranda to the World Bank and to Minister Ongpin. The note to Minister Ongpin could wait until next week, but that to the Bank should be sent today or tomorrow. Mr. Hicks called me this afternoon to confirm that the Bank staff intends to accept, albeit reluctantly, the Executive Order as issued and to record in the Agreed Minutes of the negotiations that the Bank expects the Fund staff to take up the issue once again at the time of the First Review.

We should probably clear the memoranda with Mr. Tait.

cc: Mr. Neiss (o/r)
Mr. Singh (o/r)
Mrs. Gurgen

Office Memorandum

Mr Karaosmanoglu called to say he was in complete agreement on this + would be conveying his deep concern to Minister Ongpin - He hoped we can get it cleared before or during the next review
PRN
12/19.

TO: Mr. Sonmez

December 18, 1986

FROM: P.R. Narvekar PRN

SUBJECT: Philippines: Executive Order Withdrawing Tax and Duty Incentives

We have received copies of Executive Order No. 93, concerning the withdrawal of tax and duty exemptions, both directly from our resident representative and from your division. As you know, the text of the Order differs substantially from an initial draft that was provided to us in July, and contains some clauses that may substantially weaken its effectiveness. These clauses provide broad scope for the Fiscal Incentives Review Board to restore any tax or duty exemptions to government or private entities. Consequently, there could be a repetition of the events of 1984, when a large-scale restoration of previously-withdrawn tax and duty privileges took place as a result of political pressure. The Order also refers to the possibility of explicit subsidies for private entities (as well as public corporations) to replace any tax privileges that are withdrawn. There is also a provision for a combination of tax privileges and explicit subsidies.

In our view, the Executive Order as issued is not in the spirit of the agreed tax reform package and should be substantially revised. In particular, Sections 1f and Section 2, which give the Fiscal Incentive Review Board considerable authority to restore various tax privileges, should be modified. As a minimum, we need to be assured of some safeguard to prevent the wholesale restoration of such privileges by the Review Board. We propose to communicate our views to Minister Ongpin.

cc: Mr. Tait
Mr. Neiss (o/r)
Mr. Singh (o/r)
Mr. Gandhi

Office Memorandum

TO: Mr. Narvekar December 17, 1986

FROM: E. Gurgen EG

SUBJECT: Philippines: Background to the Outstanding Loan Rescheduling Issue with Austria

On December 1, the Fund was notified by the Paris Club Secretariat of the Philippine authorities' request for postponement of the Consultative Group and Paris Club meetings originally scheduled for mid-December, 1986. Subsequently, the staff was informed by Governor Fernandez that longstanding differences with the Austrian government regarding the rescheduling of a certain loan had to be resolved before the meetings could take place.

The loan agreement in question was signed several years ago between Voest-Alpine, a state-owned corporation of the Austrian Government, and Semirara Coal Company (SCC) to finance equipment needed for exploitation of low-yielding coal deposits. The coal produced was to be used by the National Power Corporation (NPC) in a new power plant. In the event, NPC could not adequately use the coal produced, which resulted in below-capacity operation of the coal mine in question. Consequently, funds sufficient to service debt to Voest-Alpine could not be generated.

In early 1986, SCC (which was taken over by the government) unilaterally cancelled its contract with Voest-Alpine, claiming that the latter had not fulfilled the undertakings specified in the contract. The Austrian government claimed the reverse and proposed to reschedule the loan in question with more favorable terms. The failure of the Philippine Government to respond to the Austrian proposal has precluded the singing of a bilateral Paris Club Agreement with Austria, and hence stalled the overall debt rescheduling negotiations.

Official data on the amount that would be rescheduled under the Austrian loan is not readily available. Based on information contained in a newspaper article, it appears that the amount involved is approximately U.S. $130-150 million.

Attached are (i) a recent communication on this subject from the Austrian Ministry of Finance to the Alternate Executive Director for Austria, and (ii) copy of an earlier note by Mr. Keller on the same subject.

Attachment

cc: Mr. Singh
Mr. Goldsbrough
Mr. Lipton

December 4, 1986

This is a telex from Dr. Weissbacher, Federal Ministry for Finance, Austria to Mr. Schneider, Alternate Executive Director for Austria at the IMF dated December 1, 1986

Subject: Debt Rescheduling with the Philippines

Making reference to earlier telexes on this subject, the Ministry of Finance informs that the bilateral agreement with the Philippines on the basis of the December 1984 Agreed Minute could not yet be concluded.

During the last round of meetings of the Paris Club, creditor countries were informed that the Philippines has requested a debt rescheduling. In view of the IMF decision of October 24, 1986 (approval of stand-by) the Paris Club scheduled a session with the Philippines tentatively for December 15, 1986. The President of the Paris Club has informed the Philippine Minister of Finance that creditor countries were, in principle, agreeable to a multilateral rescheduling. However, he reminded at the same time that the bilateral agreement with Austria had not yet been concluded.

On the Austrian side, in response to a rescheduling proposal by Minister Concepcion, an invitation to bilateral debt rescheduling discussions was issued for December 9, 1986 in Vienna, Austria together with an Austrian proposal for the resolution of the problems with the renegotiation package. The issue continues to be the need for a solution of the problems arising from the SEMIRARA Coal Project. A Philippine response to the Austrian proposals and the proposed dates for negotiations is still outstanding.

A final Austrian decision regarding participation in a new round of multilateral debt reschedulings in the Paris Club will depend on the Philippine reply or, respectively, on the result of the negotiations on December 9 and 10, 1986. The decision, if Austria will have to appeal to the solidarity of creditor countries (in any case a delay of the multilateral negotiations) to conclude a multilateral Agreed Minute only after the bilateral agreement with Austria is signed, can only be made after the response by the Philippines or the result of the negotiations. The now emerging time pressures can be traced back to the lack of preparedness by the Philippines to respond to Austrian offers on a timely basis or to accept the most generous Austrian rescheduling proposal.

The above explanations are for your personal information as well as for appropriate use and information of the relevant staff of the IMF.

for the Ministry of Finance

Dr. Weissbacher

Office Memorandum

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RECEIVED IMF CABLE ROOM

710429 ASIAN DEPARTMENT 1986 APR 28 AM 7: 32

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Fax No. 4/45-86
No. of Pages: 2

cc: PF
HA
D

April 28, 1986

ORIG: MRS. B. DILLON
CC: MR. NEISS
ASD

To : Ms. K. Burke Dillon

From : Peter M. Keller P.K.

Subject : Philippines: Paris Club Rescheduling: Bilateral Agreement with Austria

As you know, Austria so far has refused to sign the bilateral agreement with the Philippine Government. Mr. Neiss suggested you may be interested in obtaining some additional background on the issue.

Several years ago, Voest-Alpine signed an agreement with Semirara Coal Company (SCC) to deliver coal mining equipment to exploit a deposit of low-yielding coal. Voest-Alpine is a state-owned corporation of the Austrian government, and it had obtained export guarantee and financing through the Austrian Kontrol Bank. The National Power Corporation (NPC), at that time, agreed to purchase the coal and use it in a new power plant to be built for this specific purpose. The proceeds from the sale of coal by SCC to NPC were to go into a sinking fund out of which the repayments to Voest-Alpine were to be serviced. According to Austrian sources, the mining equipment was provided and the coal deposits are being exploited as as originally agreed, with the coal quality and quantity within the parameters of the original contract. However, the electricity plant built for NPC was designed inappropriately for the quality of the coal. As a result, it is necessary to mix the local coal with imported Australian 1/ coal for the power plant to work. This has resulted in the local coal mine producing only at less than half of its technical capacity. SCC thus was unable to meet the contributions to the sinking fund for debt service payments to Voest-Alpine. SCC, which in the meantime has been taken over by the government, claimed that Voest-Alpine did not fulfill its contract. In early 1986, before the recent change in the Philippine government, SCC unilaterally cancelled the Voest-Alpine contract claiming that it had been misled. The Austrian government view, I was told, is that (a) the mining equipment is working as specified, (b) the quality of coal is also as specified, and (c) it was NPC's fault for ordering and installing an inappropriate electricity generating plant.

1/ The former Minister of Energy, who was in-charge of NPC at that time, is alleged to have bought, for his personal investment, coal fields in Australia. He has since left the country.

I was told that the Austrian Ambassador found that the coal mine is working and the NPC is actually using some of the coal from that mine for blending with Australian coal. The Austrian position apparently is that they are willing to reschedule this loan as part of the Paris Club and are even willing to concede more favorable terms for this specific loan, i.e., with much longer grace period and final maturity. The old Philippine government in early 1986, as mentioned above, refused to honor the loan agreement and authorized Voest-Alpine to remove its mining equipment if it wants to do so. This, however, may not be a very practical proposal for the Austrian side.

Voest-Alpine, the Austrian Kontrol Bank, the Austrian Ambassador, and other Austrian officials from the Ministry of Finance have tried to negotiate with the new government. So far, the Austrians feel that the new government has not been responsive. Thus, it is likely that Austria will continue to insist on the validity of the original loan agreement and will not sign the bilateral Paris Club agreement. This could also prove an obstacle to any future Paris Club discussions.

cc: Mr. Neiss
Mr. Karlik

PRN
AS 1/5/87

~~Hubert~~ – Will you be taking care of this. PRN 12/1

Office Memorandum

TO: Mr. Narvekar
Mr. Neiss

December 16, 1986

FROM: Anoop Singh AS

SUBJECT: Philippines: Forward Planning for Staff Work

First Review

Attached is a proposed mission schedule with the work program (Attachment 1). We need to settle the mission dates with the authorities as they have not yet been discussed with them. The date for the start of the mission allows us at least a week in Washington after the February 2 referendum to assess the outcome before our departure from Washington. If you agree, it would be useful to bring these dates to the attention of Minister Ongpin and Governor Fernandez as soon as possible so as to ensure that they do not make other commitments for this period. Attached is a draft message that you could consider sending to the authorities (Attachment 2). 1.

JK will discuss with GF & JO Feb 18 - March 6 and inform us.

An issue regarding FAD participation needs to be resolved. We would prefer Mr. Gandhi to be the FAD member. However, Mr. Catsambas has been proposed. There have been so many changes in FAD's participation in the Philippine work to make it quite unsettling. In the last three years, I am sure there have been at least six changes. For the first review, a great deal of emphasis will be accorded to the assessment of the implementation of the tax reform package and Mr. Gandhi will be best placed to undertake this assessment. If you agree, you could tell Mr. Tanzi our preference and assure him that we will be happy that Mr. Catsambas comes on board after the first review. Meanwhile, we have been handicapped without FAD input in recent months. 2. ?

Mr. Tait will try to get VG, but cannot confirm yet

Regarding World Bank participation--a mission will be in Manila that will overlap with ours. A Bank staff member from that mission would coordinate with us regarding the 1987 and the medium term investment programs.

1987 Article IV Consultation / Second Review

I have been giving some thought to the timing of the mission that would conduct the second review and also the 1987 Article IV consultation. There would be the obvious advantage in having one mission do both of these. The 1986 Article IV consultation discussion at the Executive Board was held on October 24--this gives us until January 24, 1988, under the 12-15 month rule, to hold the 1987 Article IV consultation (the fact that the 1987 consultation would actually be completed at the Executive Board in early 1988 would not be of material consequence).

My proposal is that a mission for the above purposes take place during the second half of October 1987 (the annual meeting period is September 29 - October 2). This would allow a staff paper to be circulated to directors in mid-December, with an Executive Board Meeting in mid-January. *

Approval of the above would require modification of the schedule incorporated in the stand-by arrangement that envisages the completion of the second review, at the Executive Board, by December 1, 1987 (Table 1). The present schedule links the September 30, 1987 performance criteria to the second review. Such a modification as proposed above would require that the (final) drawing, that linked to December 1987 criteria, be contingent upon the second review.

There are several advantages from this:

1. The present schedule would require a mission before the annual meeting, probably during the second half of August. This would result in some bunching of Executive Board papers and discussions (with the first review having been discussed in late May) and then a relatively long gap until the 1988 stand-by and/or consultation mission.
2. It would be useful to keep the policy dialogue under this stand-by arrangement alive at least through the end of 1987, bearing in mind that the arrangement does extent until April 24, 1986.
3. If the first review is delayed this would exacerbate the bunching problem.
4. Many important policy measures, certainly some of the implementation of the next round of import liberalization, as well as of important components of the GFI and non-financial public sector reform will probably be effective only at end-1987. A late second review would keep us in the game.

If it is believed that there would be too long a gap between February/March and the proposed October mission, a staff visit could be scheduled for the summer.

* Let's discuss this. There is still merit in having the 2nd review before the Annual Meeting, as scheduled, and have the consultation, together with negotiations for a new arrangement in early 1988.

HW

ATTACHMENT 1

MISSION SCHEDULE

Country: Philippines

Dates of Mission: Feb 18-March 6

(x) Tentative
( ) Agreed with ED
( ) Finalized with authorities

Mission Members: Anoop Singh
David Goldsbrough
Emine Gurgen
David Lipton
Ved Gandhi/Thanos Catsambas
Chungsuk Cha
Secretary
(World Bank input likely to be provided by Bank staff member who will be on Bank mission)

		Scheduled	Submitted	
Questionnaire:	To fax -	January 20	....	
Briefing Paper:	To Front Office -	January 23		
	To Departments 1/ -	January 29		
	To Management -	February 5		
Staff Report: (x)	To Front Office -	March 27		Reviewer:
	To Departments 1/ -	April 2		
( ) CFF	To Management -	April 7		
(x) Stand-by Review	To Secretary's -	April 14		
RED:	To Front Office -	N/A		Reviewer:
	To Departments -			
	To Secretary's			

(90-days' deadline):

Special Work Assignments:

Area	Responsibility	ASD Contact
Investment Policy Review 2/	ASD/ETR	EG
Assessment of 1986 Tax Reform 2/	FAD	DG
Public Investment	ASD/World Bank	EG
Monitoring Tables	ASD	EG/Cha
Import Functions	ETR	DL

Next Schedule		Date		Date
Consultations:	(12-15 cycle:)	) Separate	(18-24 cycle:)	
Second review:		) Memorandum		

1/ World Bank.
2/ For Annexes to the Staff Report.

Office Memorandum

ATTACHMENT 2

TO: Minister Ongpin
Governor Fernandez

December 17, 1986

FROM: P.R. Narvekar

SUBJECT: Planning of First Review Mission

I have recently returned to Washington after being in Tokyo for the Japan Consultation and, subsequently, making a short visit to Jakarta. Let me take this opportunity to thank you for receiving me so well in Manila. I was very appreciative of the arrangements you had made and enjoyed very much the meeting with the President.

Looking ahead, next on the agenda would be the visit of the first review mission. We would like to propose that the mission arrive in Manila on February 18, 1986, and stay for about two weeks. This timing would allow staff papers to be prepared by late March and to be circulated to Directors during the first half of April. Board consideration would be during May. I would be grateful for your confirmation that these dates would be convenient to you.

During January, we hope to send a limited questionnaire to your officials that would facilitate the mission's discussions. In due course we would also be sending to you the precise arrival details of the mission and its composition. The mission will be headed by Anoop Singh.

Office Memorandum

cc: HN Div.

Mr. Neiss
OK
RDE Aug 25, 1986

Revised (memo)

TO: The Acting Managing Director

August 25, 1986

FROM: Hubert Neiss HN

SUBJECT: Philippines: Your Communication to Minister Ongpin

Attached for your approval is a revised draft cable, with the added portions underscored (Attachment I). It has been reviewed by Messrs. Tait and Brau.

In view of Minister Ongpin's message of this morning (Attachment II) that decisions on further import liberalization will now not be taken until end-October, we have strengthened your communication to the authorities. It now conveys to the authorities that the delay in further import liberalization may also delay Management approval of the program beyond the original target of mid-September (this would mean Management approval would not be secured in time for President Aquino's mid-September visit to the United States, as was their original expectation).

We have planned to meet World Bank staff tomorrow to assess the progress that has been made since the mission's return on the reform of the Government financial institutions, as well as to ascertain the World Bank's position on the delay in import liberalization.

Attachments

cc: Mr. Tanzi
Mr. Brau
Mr. Brown

1986 AUG 25 PM 4: 12
OFFICE OF THE DEPUTY MANAGING DIRECTOR

RECEIVED
1986 AUG 26 AM 10: 19
ASIAN DEPARTMENT

cb60818ph1

ATTACHMENT I

TO - MR. JAIME V. ONGPIN, MINISTER OF FINANCE, MANILA, PHILIPPINES
- MR. JOSE B. FERNANDEZ, JR., GOVERNOR, CENTRAL BANK OF THE PHILIPPINES, MANILA, PHILIPPINES.

I HAVE REVIEWED THE ECONOMIC PROGRAM THAT WAS DISCUSSED WITH THE RECENT MISSION AND ALSO THE DRAFT MEMORANDUM ON ECONOMIC POLICIES THAT WAS NEGOTIATED BY THE MISSION. I BELIEVE THAT THE BALANCE IN THE PROGRAM BETWEEN THE FISCAL AND MONETARY POLICIES AND STRUCTURAL REFORMS IS APPROPRIATE TO ACHIEVE A RECOVERY WHILE MAINTAINING PRICE STABILITY AND A MANAGEABLE EXTERNAL POSITION. I WOULD LIKE TO EMPHASIZE THAT A CAUTIOUS FISCAL POLICY WILL BE ESSENTIAL IN ENSURING PRIVATE SECTOR CONFIDENCE AND ESTABLISHING THE ECONOMIC CONDITIONS CONDUCIVE TO A RESUMPTION OF PRIVATE INVESTMENT. ALSO, THE FULL IMPLEMENTATION OF THE STRUCTURAL ELEMENTS OF THE PROGRAM WILL BE ESSENTIAL IN ENSURING THAT THE RECOVERY WILL BE SUSTAINED.

IN LIGHT OF THIS, I WOULD LIKE TO STRESS THE IMPORTANCE OF TWO OUTSTANDING ISSUES AND URGE THAT YOU MAKE AS MUCH PROGRESS AS POSSIBLE IN ADDRESSING THEM DURING THE COMING DAYS. FIRST, WE FOLLOW WITH INTEREST YOUR DISCUSSIONS WITH THE WORLD BANK ON THE REFORM OF THE GOVERNMENT FINANCIAL INSTITUTIONS AND WE AWAIT WORLD BANK ASSURANCE THAT THE ESSENTIAL DETAILS, IN LINE WITH THE REFORM PRINCIPLES OUTLINED IN YOUR DRAFT MEMORANDUM ON ECONOMIC POLICIES, ARE IN PLACE. SECOND, WE WOULD HOPE THAT THE HEARINGS PRESENTLY BEING CONDUCTED ON THE FUTURE COURSE OF IMPORT LIBERALIZATION POLICY WILL RESULT IN A RESUMPTION OF THE LIBERALIZATION ESSENTIAL TO THE OUTWARD LOOKING STRATEGY THAT IS

PART OF THE PROGRAM. AS YOU KNOW, IT HAS BEEN THE FUND'S POSITION THAT THE REMAINDER OF THE ITEMS SCHEDULED FOR LIBERALIZATION BY APRIL 1986 SHOULD BE LIBERALIZED PROMPTLY. YOUR RECENT MESSAGE THAT NO DECISION ON THE RESUMPTION OF LIBERALIZATION WILL BE MADE BEFORE END-OCTOBER IS, THEREFORE, DISAPPOINTING AND WILL DELAY OUR ENVISAGED TIMETABLE FOR THE PROGRAM. I REALIZE THE DIFFICULTIES INVOLVED. HOWEVER, ACTION IN THIS AREA IS NECESSARY TO IMPROVE THE EFFICIENCY AND COMPETITIVENESS OF THE ECONOMY, PARTICULARLY IN THE EXPORT SECTOR. IT WILL ALSO CONVINCINGLY INDICATE THE GOVERNMENT'S RESOLVE TO CHECK VESTED INTERESTS AND MONOPOLIES WHICH ARE DETRIMENTAL TO ECONOMIC PROGRESS.

ONCE I HAVE RECEIVED ASSURANCES THAT SUFFICIENT PROGRESS IN THE TWO ABOVE AREAS HAS BEEN MADE, MANAGEMENT WILL BE PLEASED TO ANNOUNCE ITS ACCEPTANCE OF THE PROGRAM AND RECOMMEND IT FOR EXECUTIVE BOARD CONSIDERATION. AS YOU KNOW, WE HAD ORIGINALLY PLANNED THAT THIS PROCESS WOULD BE COMPLETED IN EARLY SEPTEMBER, BUT THIS WOULD NOW ONLY BE POSSIBLE IF YOU COULD RECONSIDER THE TIMETABLE FOR IMPORT LIBERALIZATION.

YOURS SINCERELY

RICHARD D. ERB

ACTING MANAGING DIRECTOR

INTERFUND

ATTACHMENT II

Page No. 2 - 3
Fax No. 8/24-86
August 25, 1986

TELEX FOR TRANSMISSION

25 AUG 86

ATTENTION HUBERT NEISS, IMF

SUBJECT: IMPORT LIBERALIZATION

RE AGREEMENT ON SUBMISSION BY PHILIPPINE GOVERNMENT OF PLAN FOR LIFTING OF IMPORT CONTROLS ON 137 ITEMS BY END OCTOBER, MINISTRY OF TRADE AND INDUSTRY HAS COMPLETED FIRST-ROUND CONSULTATIONS WITH CONCERNED SUB-SECTORS ON DATA REQUIREMENTS AND FACTORS TO BE CONSIDERED IN PREPARING SAID PLAN. ALL REQUIREMENTS EXPECTED TO BE SUBMITTED BY CONCERNED SECTORS BY SEPTEMBER 15, AFTERWHICH BOI, NEDA AND TARIFF COMMISSION WILL DETERMINE SPECIFIC ACTIONS FOR EACH ITEM OR SCHEDULE PUBLIC HEARINGS IF NECESSARY.

MINISTER CONCEPCION IS CONFIDENT FINAL PLAN WILL BE READY FOR SUBMISSION AND DISCUSSION WITH IMF END OCTOBER.

FOR YOUR ADDITIONAL INFORMATION, ATTACHED IS SCHEDULE OF CONSULTATIONS RECENTLY COMPLETED.

JAIME V. ONGPIN
MINISTER

XC: JSC
SCM
JBF
AGR
EL/RKK

ATTACHMENT II

SCHEDULE OF CONSULTATIONS

DATE			No. of Items
04 August	-	Polyvinyl Chloride Resin	2
	-	Caustic Soda	2
	-	Asbestos-Vinyl Tiles/Sheets	2
05 August	-	Nylon Filament Yarn	9
	-	Polyester Staple Fiber and Filament Yarn	11
	-	All Spun Yarns and Threads	61
	-	Textiles and Fabrics	77
06 August	-	Synthetic (Plastic) Resins	14
07 August	-	Pulp and Paper and Paperboard Products, including Printed Materials and Paper Packaging Materials	71
08 August	-	Food Products Included in the List of High Tariff Items	12
	-	Plus Canned Sardines and Mackerel	2
11 August	-	Household and Decorative Ceramic Products Included in the List of High Tariff Items	4
12 August	-	Rubber Based Products Included in the List of High Tariff Items	7
14 August	-	Wood Based Products Included in the List of High Tariff Items	3
15 August	-	Cigars and Cigarettes Included in the List of NEC/UC Items	7
18 August	-	Monosodium Glutamate Included in the List of High Tariff Items	1
22 August	-	Basic Refractories	5
25 August	-	Iron and Steel Products	43
			333

*Tires	10
Comic Books	1
High Tariff Items including Sugar	4
	15

15

348

*Previous consultations already held.

PRN

N 5

Office Memorandum

To: Mr. Singh

August 25, 1986

From: Alan A. Tait

Subject: Suggested Draft for Paragraph in Management's Note to Mr. Stern

The Fund would have preferred a smaller public sector deficit, especially given the heavy emphasis on spending in the second half of 1986. However, we accommodated this deficit by emphasizing the structural reform in taxation and the carefully monitored expenditure on investment and maintenance. This last is predicated on the Bank's review of the investment program, the ordering of priorities, and the justification of investment expenditures in terms of their viability and contribution to domestic and external adjustment; clearly a great deal is asked of the Bank staff in the coming few months.

HN

AS

pl. take care of this

Office Memorandum

TO : Mr. Singh DATE: August 25, 1986

FROM : Werner Dannemann WD

SUBJECT : Briefing Paper on External Debt Statistics Mission to the Philippines

I attach Mr. Flinch's briefing paper on his forthcoming mission to the Philippines. I am also sending copies to Messrs. Burton and Goldsbrough. It would be appreciated if comments could be sent to Mr. Flinch by noon, Wednesday, August 27, 1986.

Attachment

cc: Mr. Burton
Mr. Goldsbrough

Office Memorandum

cc: HN Div.

Mr. Neiss
OK
DDE Aug. 25, 1986

Revised (memo)

TO: The Acting Managing Director

August 25, 1986

FROM: Hubert Neiss HN

SUBJECT: Philippines: Your Communication to Minister Ongpin

Attached for your approval is a revised draft cable, with the added portions underscored (Attachment I). It has been reviewed by Messrs. Tait and Brau.

In view of Minister Ongpin's message of this morning (Attachment II) that decisions on further import liberalization will now not be taken until end-October, we have strengthened your communication to the authorities. It now conveys to the authorities that the delay in further import liberalization may also delay Management approval of the program beyond the original target of mid-September (this would mean Management approval would not be secured in time for President Aquino's mid-September visit to the United States, as was their original expectation).

We have planned to meet World Bank staff tomorrow to assess the progress that has been made since the mission's return on the reform of the Government financial institutions, as well as to ascertain the World Bank's position on the delay in import liberalization.

Attachments

cc: Mr. Tanzi
Mr. Brau
Mr. Brown

1986 AUG 25 PM 4: 12
OFFICE OF THE DEPUTY MANAGING DIRECTOR

RECEIVED
1986 AUG 26 AM 10: 19
ASIAN DEPARTMENT

cb60818ph1

ATTACHMENT I

TO - MR. JAIME V. ONGPIN, MINISTER OF FINANCE, MANILA, PHILIPPINES
- MR. JOSE B. FERNANDEZ, JR., GOVERNOR, CENTRAL BANK OF THE PHILIPPINES, MANILA, PHILIPPINES.

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YOURS SINCERELY

RICHARD D. ERB

ACTING MANAGING DIRECTOR

INTERFUND

ATTACHMENT II

Page No. 2 - 3
Fax No. 8/24-86
August 25, 1986

TELEX FOR TRANSMISSION

25 AUG 86

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SUBJECT: IMPORT LIBERALIZATION

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MINISTER CONCEPCION IS CONFIDENT FINAL PLAN WILL BE READY FOR SUBMISSION AND DISCUSSION WITH IMF END OCTOBER.

FOR YOUR ADDITIONAL INFORMATION, ATTACHED IS SCHEDULE OF CONSULTATIONS RECENTLY COMPLETED.

JAIME V. ONGPIN
MINISTER

XC: JSC
SCM
JBF
AGR
EL/RKK

ATTACHMENT II

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			333

*Tires	10
Comic Books	1
High Tariff Items including Sugar	4
	15

15

348

*Previous consultations already held.

Office Memorandum

N

Noted

cc: HN Div.

S

TO: The Acting Managing Director

August 20, 1986

FROM: P.R. Narvekar PRN

SUBJECT: Philippines--Tax Package

The U.S. Executive Director's office has invited a group of Congressional staff to explain to them the Philippine tax reform. The meeting will take place on September 9, and Ms. Bush has asked Messrs. Tanzi, Gandhi, Neiss, and Singh to participate.

For your information.

RECEIVED
1986 AUG 25 PM 3:14
ASIAN DEPARTMENT

cc: Mr. Brown

1986 AUG 21 PM 5:12
OFFICE OF THE DEPUTY MANAGING DIRECTOR

INTERNATIONAL MONETARY FUND N

August 20, 1986

~~Mr. Narvekar~~
Mr. Neiss:

Subject: Telephone Call From
Mr. de Forges (France)

Mr. de Forges rang to inquire about our timing for the Philippine program. I told him where we are. In particular, he wanted to know if the program would have special features or exclusions as in the Mexican case. I said not. In fact, I volunteered the view that we would be presenting a more consolidated picture of the public sector.

AS

Anoop Singh

Office Memorandum

August 21, 1986

MEMORANDUM FOR FILES

Subject: Philippines: Inquiry from an Executive Director

Mr. Romualdez called me this morning. He had seen a number of press reports from the Philippines indicating that agreement with the Fund had been finalized, and he wished to know if this was correct. I explained that there had been no change in the situation reported to him earlier; we were still awaiting progress by the authorities on two outstanding issues--trade liberalization and the government financial institutions--and that we hoped such progress would be achieved by mid-September.

D. Goldsbrough

David Goldsbrough
Senior Economist
Asian Department

cc: Mr. Narvekar
Mr. Neiss
Mr. Singh

Office Memorandum

TO: The Acting Managing Director — August 20, 1986

FROM: P.R. Narvekar PRN

SUBJECT: Philippines--Tax Package

The U.S. Executive Director's office has invited a group of Congressional staff to explain to them the Philippine tax reform. The meeting will take place on September 9, and Ms. Bush has asked Messrs. Tanzi, Gandhi, Neiss, and Singh to participate.

For your information.

cc: Mr. Brown

c.

Office Memorandum

TO: The Acting Managing Director August 19, 1986

FROM: P.R. Narvekar and Eduard Brau PRN

SUBJECT: Philippines--Letter of Intent

Attached is the draft Memorandum on Economic Policies negotiated with the authorities by the recent mission (Attachment I). It has been reviewed by Messrs. Hood (RES), Tait (FAD), Francotte (LEG), Decarli (TRE), and Sonmez (IBRD). Attached also is a draft forwarding letter which tries to accommodate the authorities' request to strike a new tone of equal partnership with the Fund in the new arrangement (Attachment 2). It has been reviewed by LEG.

ETR has expressed concern about the size of the 1986 fiscal deficit, particularly in the second half of this year. ASD and FAD, on balance, find the deficit for 1986, as negotiated in the Letter of Intent, acceptable. The respective positions are outlined in Attachments 3 and 4. In their comments on the Letter of Intent, the IBRD staff have reiterated that they are satisfied with the level and composition of public expenditures and that the level should remain unchanged for the remainder of the year.

The Philippine authorities await Management reaction to the program and have already been in touch with us since the mission's return. As outlined in Mr. Neiss' back-to-office report, we recommend significant further steps in import liberalization and the completion of essential details on GFI reform prior to Management's acceptance of the program. The authorities' aim is to secure Management approval by early September, i.e., prior to President Aquino's visit to the United States.

A draft cable to the authorities is attached (Attachment 5).

For your approval.

Attachments

cc: The Managing Director (o/r)
Mr. Tait
Mr. Brown

Corrections proposed after the mission's departure are identified separately. (/ indicates proposed deletion and underlined portions are proposed additions).

PHC:csr6phatI (8/18/86)

September 15, 1986

THE GOVERNMENT OF THE REPUBLIC OF THE PHILIPPINES

Memorandum on Economic Policy

1. This ~~letter~~ memorandum summarizes the achievements and sets out the policies and measures which the Government would implement in order to achieve economic recovery in the short term and sustainable growth in the long run.

2. The Philippine economy has experienced negative real growth rates since 1984. Real per capita income has declined by an average of 5.5 percent during the last three years. This has severely strained the economic and social fabric of the country. The policies that we have formulated are designed to initiate a recovery and provide for the resurgence of sustained growth and improvement of equity, in an environment of price and balance of payments stability. Achievement of these objectives will not be an easy task. It will require a major change in the systems of economic management from those that have operated for many years and that restricted competition in a number of key sectors of the economy. The policies that we can pursue will also have to take account of the substantial financial imbalance of the public sector in the first quarter of the year, an event that was directly associated with the February 7 election and was also the result of the impairment of the financial position of government corporations and financial institutions after several years of improper direction. However, we believe, that the prospects for a recovery based on a revival of private

sector activity have improved with the recent political changes which have already had a major salutary effect on domestic and international confidence.

Major objectives of the program

3. We have formulated a new economic program that provides for the start of an economic recovery in the second half of the year. The extent of this recovery should more than offset the estimated economic decline during the first half, so that some positive growth in 1986 as a whole should now be possible. Our macroeconomic projections, summarized in Table 1, provide for a substantial recovery of 6-7 percent in 1987.

4. Our policies are designed to achieve this recovery without jeopardizing the progress made in the reduction of inflation. It is our objective to contain the average inflation rate within 5-6 percent during the program period, which will be broadly in line with international trends.

5. The program targets for a modest external current account surplus in 1986 and a small deficit (about 1 percent of GNP) in 1987 due mainly to the projected rebound of imports with the recovery. Although this achievement will be more reflective of the decline in international oil prices, rather than a recovery of exports, we believe that the policies that will be pursued during this period will lay a firm foundation for export growth. The program has an associated exceptional financing need, involving both reschedulings as well as the provision of new money, and is designed to achieve a restoration of gross international reserves to about three and a half months of imports and service payments and their maintenance at this level thereafter.

Domestic financial policies

Public sector

6. It will be the Government's intention to achieve an enduring reduction in the public sector deficit (defined to include the national government and the 14 major public corporations) over the program period, as described in Table 1. This will be accomplished through structural reforms designed to achieve a long-term improvement in the public sector's resource mobilization, and a number of expenditure measures. Thus, we have targeted that the public sector deficit be limited to 5.5 percent of GNP in 1986 and reduced to 2.9 percent of GNP in 1987 and to 2.6 percent of GNP in 1988.

7. Consistent with this scenario, the national government deficit will be limited to 4.4 percent of GNP in 1986 and, on the basis of present projections, reduced to 2.4 percent of GNP in 1987 and to under 2 percent of GNP by 1988. The Government has reformulated the 1986 national government budget in light of the new priorities that include increased support for rural based employment-oriented programs and projects. These have been reflected in a re-appraisal of the expenditure and investment program and a new tax reform program. Our latitude during 1986 is somewhat limited because of the need to contend with the large deficit incurred in the first quarter. The deficit for 1986 as a whole will, therefore, amount to ₱ 27.9 billion. We expect ₱ 8.0 billion of this deficit to be financed by net external borrowing and the bulk of the remainder will be financed through the sale of Treasury Bills and Notes in the domestic market largely under an auction system.

8. The tax reform measures that contribute to a 1986 revenue target of ₱ 86.5 billion are described in paragraph 26 below. While we expect tax administration measures to yield ₱ 5.5 billion in 1986 we have, as a measure of caution, incorporated only ₱ 3.5 billion in this revenue target. We have instituted a wide range of measures, including tax amnesties, collection of delinquent accounts, and an incentive scheme for tax officials, to ensure achievement of this target. However, if these tax administration measures do not yield this amount of revenue, the Government will make corresponding reductions to the expenditure program, or increase other revenues, in order to limit the deficit to the projected level. On the other hand, if ~~the tax administration measures yield the full targeted amount of ₱ 5.5 billion, the deficit will be reduced to ₱ 25.9 billion correspondingly~~ total revenues exceed the targeted amount of ₱ 86.5 billion, the deficit target of ₱ 27.9 billion will be reduced correspondingly.

9. The capital expenditure program (National Government and corporations) is described in paragraph 27. It aims at providing sufficient resources for the continued implementation of priority on-going programs and projects for maintenance of existing infrastructure, and for new priority projects which are essentially employment-generating. The Ministry of Budget and Management has installed a new system of expenditure control designed to keep expenditures within targeted levels and to ensure the effective implementation of the expenditure program. Since March 1986, the new administration has been drastically changing the budget system to attain an optimum balance between control procedures and measures to facilitate disbursements on priority projects. A

salient feature of these changes is the shift to a "funding warrant scheme." Currently on trial during the second semester of 1986 in four agencies is the monthly release by the Office of Budget and Management (OBM) of funding warrants which will trigger the setting-up of bank deposit accounts of government agencies. This modifies the existing system based on Cash Disbursement Ceilings (CDCs) which authorize agencies to issue checks against a central account. Under the new scheme, an agency will not be able to disburse in excess of authorized ceilings since disbursements are automatically limited to the balance of its deposit accounts. We have also minimized the flexibility of agencies to reprogram subaccounts in the maintenance funds. We will also strengthen the NEDA-OBM system for physical and financial monitoring of projects to ensure that funds are not diverted to other uses.

We also intend to monitor carefully implementation of the investment program so as to ensure that essential projects are not held up due to shortage of counterpart resources. For this purpose, a monitoring system has been installed mobilizing agency regional offices and non-governmental organizations to ensure that the expenditure program supports the identified priority activities. Overall, the expenditure control system now prevents the redirection of unspent amounts under given budgetary items to other categories.

10. We will continue to monitor closely the policies, performance and the financing need of a group of 14 major nonfinancial public corporations. For this group of corporations, we have targeted the overall deficit to be limited to 2.3 percent of GNP in 1986 and to decline to 1.6 percent of GNP in 1987 and, further, to 1.3 percent of GNP in

1988. We expect this reduction in the combined overall deficit of the corporations to result from a wide range of structural measures that we intend to implement over the program period so as to reduce their dependence upon the national government budget. These reforms, which are described in paragraph 28 below, are also intended to reduce greatly the scope of government. These measures will, in time, reduce the financing need which, in 1986, will be limited to ₱ 14.3 billion. The domestic financing need will be greater by ₱ 2.2 billion which is the projected net repayments on foreign financing.

11. Taking account of the projected national government deficit and the policies and performance of the 14 major public nonfinancial corporations, we have placed a limit of ₱ 34.5 billion for the 1986 public sector borrowing requirement (PSBR). Consistent with this, we have established quarterly targets that limit the PSBR to ₱ 29.3 billion through October 31, 1986, to ₱ 34.5 billion through December 31, 1986, and to ₱ 5.0 billion for the period January 1-March 31, 1987 (Table 2). Quarterly limits for the remainder of the program period will be established in the course of the planned two reviews with the Fund.

Monetary program

12. We have formulated a monetary program that provides for the anticipated recovery in the second half of the year while achieving the stability objectives of the program. This program has already resulted in a major decline in interest rates and we expect them to fall further in the coming months, while remaining positive in real terms. It will be our intention to limit the growth in the monetary base (base money)

during 1986 as a whole to 15 percent, allowing broad money growth of 13 percent. For 1987, we have established an indicative target for the expansion in base money of 16 percent and for the expansion in broad money of 15 percent, consistent with the growth, price, and external assumptions of the program. The monetary projections assume a progressive reflow of currency back into the banking system, following the substantial expansion in currency in the early months of the year, and a return toward normal currency demand relationships. We have established a quarterly phasing that limits base money to ₱ 47.5 billion at October 31, 1986, to ₱ 51.0 billion at December 31, 1986, and to ₱ 50.8 billion at March 31, 1987. These limits will be adjusted upwards by the amount of additional purchases of foreign exchange by the Central Bank that results in an improvement in NIR beyond the program targets for these dates up to a maximum of ₱ 2 billion (Table 2). These limits will accommodate the credit needs of agriculture and the rest of the private sector consistent with the anticipated recovery. Quarterly limits for base money for the remainder of the program period would be set in the course of the two program reviews.

13. In recent years, net payments by the Central Bank have required the issuance of Central Bank bills to keep monetary expansion within the stabilization program. These payments have arisen from the unwinding of forward cover and swap contracts entered into prior to October 1983, bank rescue operations and the assumption by the Central Bank of public and private sector liabilities under the External Restructuring Agreements. These operations carry with them implications for future

Central Bank operations that tend to reduce flexibility. We have therefore decided to monitor closely these developments and have taken steps to avoid similar transactions in the future. In particular, we have discontinued providing new cover on long-term swap and forward contracts and have agreed that the Treasury will hereafter gradually assume the responsibility for floating both short- and long-term bills. Central Bank net interest payments will be monitored closely and contained.

14. Monetary management continues to be complicated by strains in the financial system. Measures already taken and intended to rationalize financial organizations and encourage a stronger banking system have produced the following results. Capital accounts have increased by 29 percent from December 1983 to June 1986. Reserve deficient banks have been reduced in number from eight at year-end 1984 to seven in 1985 and to three on June 30, 1986. Net operating profits showed a modest growth during the same period. A total of 24 institutions were absorbed through merger, consolidation or buy-outs. Fifty-one petitions for assistance in liquidation were filed.

The following further steps are contemplated to reinforce measures to strengthen the system:

(a) A closer monitoring of overseas branches and affiliates;

(b) more effective supervision not only of bank portfolios and the composition of liabilities but also of net operating results, in particular, the stability and diversity of earnings and the level and effectiveness of costs;

(c) a better appraisal of the competence and depth of managerial skills;

(d) a better appraisal of the soundness and quality of controls over new banking services offered.

15. In addition, a number of steps have been taken to reduce the high cost of intermediation which has tended to require wider margins between bank deposits and lending rates. Reserve requirements have been reduced by 2 percentage points from their peak of 24 percent. Interest on reserve balances at the Central Bank have been increased from 3 percent to 4 percent and the composition of reserve eligible assets to meet the legally required funding for agriculture and agrarian reform, in addition, has been changed to reduce effective cost penalties for such reserves. Continuing studies to further this process are being made particularly in the matter of the existing gross receipts tax on banks and on the reserve requirement for agriculture and agrarian reform funding. All of these steps shall be undertaken within the agreed monetary programs.

16. Specific reforms in respect of the government banking institutions, whose foreign debt service obligations have placed a heavy burden on the National Government, are described in paragraph 31 below. In order to preserve the financial program, we will continue to monitor closely Central Bank credit to the Philippine National Bank (PNB). It is intended that the PNB's access to Central Bank resources will be limited to normal commercial operations and that there will be no special extension of credit to or implied subsidy of the PNB. As such, Central Bank credit to PNB (excluding normal rediscounting) which amounted to ₱ ~~3.0~~ ₱ 3.6 billion at June 30, 1986 will not exceed ~~this level~~ ₱ 3.0 billion at October 31, 1986, December 31, 1986 and March 31, 1987. However,

should additional Central Bank assistance become necessary to meet abnormal private deposit movements, we expect that this would be considered in assessing performance under the above limits. Limits for the remainder of the program period will be set in the course of the two program reviews. As in the past, there will be no provision for any kind of Central Bank assistance to the Development Bank of the Philippines (DBP).

Incomes policy

17. The Government is implementing a comprehensive and equity-oriented incomes policy consisting of measures to (a) improve the terms of trade for agriculture; (b) restore the real compensation of public servants to pre-crisis levels; (c) expand the supply of basic public services; and (d) strengthen the collective bargaining process in the private sector. These will be carried out within the context of a growth-oriented program consistent with stabilization objectives.

The improvement of the terms of trade for agriculture shall be intensified through further structural reforms to remove any remaining policy biases against the sector. Specifically, the recent removal of export taxes, dismantling of trade monopolies, maintenance of price support for rice and corn, and the planned reforms in the sugar and coconut subsectors are expected to improve investment and livelihood opportunities and increase returns to small farmers.

18. For the national government, a wage increase was granted effective July 1, 1986 which raised the annualized average daily compensation (inclusive of the cost-of-living allowances) in the national government by 8.0 percent. This average increase allows a proportionately greater rise in the compensation income of national government workers with

monthly basic wages of less than ₱ 1,000. Overall, with this increase, average national government compensation incomes constitute only 88.6 percent of the real 1982 levels. While this is the only wage increase for 1986, further adjustments shall be made in succeeding years to allow the salaries of civil servants to grow in real terms. Measures will be undertaken to narrow the gap of salaries between the Government and private sectors.

19. In addition, we will review employment levels in the National Government and in the rest of the public sector. Until this review is completed, the present level of total employment in the public sector will be maintained. Eventually the composition will change to reflect the new administration's thrust, i.e., emphasis on education, health and other social services.

With reference to the private sector, we are pursuing a policy of non-intervention in wage-setting, strengthening workers' organizations and improving their access to information, and enhancing the investment climate through consistent policies and streamlined regulations. We will further strengthen collective bargaining and voluntary arbitration as a basis for settling labor-management issues.

These policies and such other measures as avoidance of taxation of incomes below the poverty line will be carried out in an environment consistent with sustainable growth and price stability. In the medium term, these are expected to bring about a growth process where overall real per capita incomes are improved, and the poverty incidence reduced to 45 percent by 1992 from 58 percent in 1985.

External policies

20. Although considerable adjustment has been made in the external accounts, export performance has remained significantly below expectations. It will therefore be of utmost importance to achieve a strengthening of exports over the program period and over the medium term. During 1986, exports are projected to be slightly below the 1985 level, in part reflecting depressed commodity prices, with a substantial recovery taking place only in 1987. In this period, imports are projected to rebound after their sharp and substantial declines during 1984-85. In sum, the external current account is projected to be in small surplus in 1986, while in 1987 the current deficit is targeted to be about one percent of GNP. These current account positions reflect also the reductions in international oil prices, greater buoyancy in non-trade receipts and some further reduction in the interest burden stemming from further declines in international interest rates.

21. Our overall balance of payments estimates for 1986 show an overall deficit of $0.8 billion on the basis of scheduled payments and an overall surplus of $1.2 billion after expected rescheduling and exceptional financing to be disbursed from official and commercial bank sources. Consistent with these projections, we have established floors for NIR of the monetary authority. Accordingly, NIR which amounted to minus $1,104 million on June 30, 1986, will have a floor of minus $1,269 million on October 31, 1986, minus $908 million on December 31, 1986, and minus $778 million on March 31, 1987 (Table 3). Quarterly floors for the remainder of the program period will be established in the course of the two program reviews. We also target that gross official reserves of the monetary authority will reach a level

of $2.4 billion by end-December 1986, equivalent to about 3.5 months of 1986 imports and service payments.

22. We intend to continue with the floating exchange rate system that we established in October 1984. As such, there will be no limit or administrative impediment to foreign exchange holdings of commercial banks in the exchange market. Exchange rate policy will be subject to review to ensure that it remains sufficiently supportive of external competitiveness in particular, vis-a-vis, major competitors, and the emergence of new export industries.

23. We have reviewed the current arrangements for the purchase of foreign exchange by the public to ensure that these arrangements are consistent with our objective of maintaining an open exchange system on current transactions. During the course of the program, the Government will refrain from the introduction of any new restrictions or the intensification of existing ones either on payments and transfers for current international transactions or on imports for balance of payments reasons and will not introduce multiple currency practices or conclude bilateral payments agreements ~~with Fund members~~ inconsistent with Article VIII.

24. In order to improve the maturity profile of the external debt, we will limit the approval of nonconcessional external loans in the 1-12 and 1-5 year maturities, and will continue to limit short-term external indebtedness over the program period. Between July 31, 1986 and March 31, 1987 we will limit approvals of nonconcessional external borrowing with original maturities of one to twelve years to $1,400 million, of which no more than $300 million will be in the 1-5 year maturity range. Short-term external debt will also continue to

be limited during the program period. The level of outstanding short-term external debt, which amounted to $9,096 million at end-March 1986 and $8,787 million at end-June 1986, will be restricted to $9,050 million between July 1986 and end-March 1987.

Limits on medium- and long-term borrowing approvals and outstanding short-term external debt for the remainder of the program period will be established during the scheduled program reviews.

25. Debt-equity conversion

A program for the conversion of Philippine external debt into equity investments has been approved by the Monetary Board. This will enable private investors to purchase Philippine public sector external debt obligations which are currently trading in the secondary markets abroad. Under the proposed program, investors would be allowed to redeem such debt for the full peso equivalent to the face amount of the obligation, provided they undertake to use the peso proceeds for long-term equity investments in the Philippines.

Structural policies

In its short period in office, the government has already made substantial progress in major areas, including reform of the tax system for equity and efficiency, abolition of monopolies particularly in the sugar and coconut sectors and a fundamental re-orientation of public expenditures. Our major accomplishments in structural reform, and our major programs for further reforms, are summarized in the following sections.

26. Tax reform

The Government has approved and is implementing a comprehensive Tax Reform Program comprising 29 measures, including both long-term structural reform measures and one-time tax amnesties. The long-term measures are aimed primarily at improving equity and promoting growth and efficiency. These include measures to globalize taxes on all incomes except passive incomes; raise personal exemptions under the income tax to avoid taxing incomes below the poverty level and provide for their future indexation; reduce and simplify business and sales taxes; abolish export taxes except on logs; reform the basis of the taxation of imports; and remove all tax and duty exemptions, with a few exceptions. The revenue measures increase taxes on beer, cigarettes and gambling, and raise the minimum import duty rate to 10 percent. Finally, there are amnesties on income and property taxes and repatriation of foreign assets (Table 4).

This program is so comprehensive that few further structural improvements are necessary in the near term. The following are intended to be undertaken:

(a) a change in the basis of customs valuation from home consumption value (HCV) to actual transaction value or CIF, with the option of using HCV if the declared CIF value is deemed unrealistic; effective not later than August 31, 1986.

(b) a series of studies on the direction of future tax reform, in particular, reviews of: (i) the timing of further globalization of the income tax; (ii) capital gains taxation; (iii) tax depreciation allowances; (iv) BOI and other incentives under various tax codes; and (v) property taxation. In these areas, we will consider implementing structural reforms, after prior consultation with the Fund, by end 1987, i.e., with the 1988 national government budget.

(c) The introduction of a value added tax, also with the 1988 budget, in place of existing sales and turnover taxes. We have already requested the Fund for technical assistance in preparing for the introduction of the value-added tax.

27. Public Expenditure Program. We believe that the medium-term public investment program should be maintained at a level of about 5-6 percent of GNP in order to ensure that adequate infrastructure is available for the recovery. The size of the investment program is based on a number of factors, including a detailed investment analysis which identifies growing deficiencies in a number of critical areas (e.g., transportation). An investment rate of 2-3 percent will be needed to cover just the replacement requirements of the capital stock. An additional growth in capital expenditures is required to meet the social infrastructure needs (health, water, education) of a rapidly growing population (over 2.5 percent per year). To ensure a more efficient use of the capital stock and reduce future rehabilitation requirements, a sustained and substantial growth in operation and maintenance (O&M) expenditures is required.

The national government budget for 1986 restores capital spending to about the same level as in 1979, through a doubling of the investment program. For the entire public sector, investment would rise from

3.5 percent last year to about 5 percent of GNP. The target increases in the national budget are in areas that will support employment-oriented rural works projects. The investment program for the corporations calls for a fairly substantial increase for NPC from ₱ 4.9 billion to ₱ 8.8 billion this year. This increase reflects, in particular, increased expenditures for the rehabilitation of existing oil-fired plants. The 1986 national budget also calls for a substantial increase in operating and maintenance (O&M) expenditures of 63 percent. This increase redresses the past trend of declining levels of O&M expenditures which have fallen 50 percent since 1982, despite an expanding capital base. The current total increase would raise the level close to the 1982 level. The restoration effort would be even larger for economic and social services.

For 1987 we propose a smaller increase of about 15 percent in nominal terms to ensure some further growth in real investment, and the efficient allocation of investment funds. The present investment program for 1987 of ₱ 34 billion implies an investment/GNP ratio of 4.8 percent.

28. Non-financial public corporations. We have inherited a large and inefficient public sector that is uncompetitive, reliant on a complex network of implicit subsidies and budgetary assistance, and representative of a massive misallocation of public resources. It is the Government's firm intention to subject this sector to the closest scrutiny with the objective of formulating policies that would improve productivity, minimize government intervention, and achieve maximum transparency of public sector operations. We have initiated wide-ranging actions

toward this end and expect to decide upon the details of such a reform, adopt a schedule of measures, and initiate their implementation by January 1, 1987. We intend the bulk of these reforms to be implemented during the program period. Some of the initiatives underway include:

(a) We are constituting task forces to conduct comprehensive management and financial audits of five major corporations.

(b) These recommendations will focus on improvements in their collection and billing efficiencies, and the rationalization of their tariff structures and expenditure programs so as to raise internal cash generation of these and the other monitored corporations. It will be our policy to (i) charge the full cost of borrowed funds on new government net lending; (ii) consider levying a charge on outstanding net lending balances; (iii) change depreciation practices to a replacement cost basis; (iv) reflect the actual cost of foreign borrowing of these corporations in their costing and prices of goods and services; and (v) implement Executive Order 518 (Section 17) which provides that all government corporations must declare dividends equivalent to 5 percent of net earnings.

(c) The Presidential Commission on Government Reorganization has submitted a plan to the Cabinet for the rationalization and privatization of the 214 non-financial government corporations. The recommendations are to privatize 87 corporations through sale, convert 8 to private associations or foundations, abolish 38, consolidate 21, convert 14 to regular government status and retain only 46.

(d) A Task Force has been established at the Ministry of Budget and Management to review and consolidate outstanding arrears, and adopt a timetable for their settlement.

29. On specific corporations, we have, for the time being, adopted the following initial measures:

(a) The National Food Authority (NFA) has (i) adopted a retrenchment program involving an annual saving of ₱ 31.3 million beginning October 1986; (ii) closed 96 KADIWA outlets effective July 1986 and formulated plans to close or sell the rest together with the Food Terminal. Other related measures are described in paragraph 34 below;

(b) The National Power Corporation (NPC) has (i) completed a study on the power tariff rate structure undertaken through NEDA, which will shortly be submitted for Cabinet action and (ii) initiated the settlement of arrears with Meralco through a Budget Ministry Task Force; and

(c) The Light Railway Transit Authority (LRTA): (i) has completed studies for a zonal tariff rate increase which it plans to implement by the end of the year; and (ii) is reviewing its present management contract with METRO with a view to cost saving.

30. Trade liberalization

In the last few months, we have made substantial progress toward our goal of reducing tariffs and other restrictions on tradeable goods. Of the 904 items scheduled for liberalization by the end of April, but postponed subject to review, all but 137 had actually been liberalized by end-July. Furthermore, the liberalized items included 80 items scheduled for liberalization on December 31, 1986 and two items scheduled for liberalization on June 30, 1987. Effective July 26, 1986 we removed all quantitative restrictions and prior approval procedures on the import of capital goods, which was previously limited to $50,000 per month.

Our further steps in this area are therefore as follows:

(a) An in-depth study, including public hearings, shall be undertaken in consultation with all affected sectors on the remaining items scheduled for April 30, 1986 liberalization, taking into consideration the appropriate level of tariff adjustments and other conditions necessary, so that the final list of items can be determined by October 31, 1986.

(b) With respect to the items scheduled for liberalization on December 31, 1986 and June 30, 1987, a similar process will be undertaken so that the program for these will be determined by December 31, 1986.

(c) Priority will be given during the hearings to imports essential to agricultural and export industries.

(d) For commodities not to be liberalized immediately, the maximum period of postponement for the exceptional cases will be May 1, 1988.

We are considering a further restructuring of the tariff system with the aim of establishing tariffs as the primary instrument for industrial protection and rationalizing variations in effective rates of protection within and across sectors. This shall be undertaken within the context of the MTN and our commitment to the GATT and ASEAN.

31. The Reform of Government Banking Institutions

We have inherited large government financial institutions which, particularly during the period preceding the financial and exchange crisis, were misused and whose operations resulted in a massive misallocation of resources. A very substantial portion of their assets, now estimated at $7 billion, is non-performing. The liquidation of obligations, mostly financed from external resources, will remain both a charge on public resources and a burden on the balance of payments for the next decade. The need for a thorough reform of the sector has been recognized and the government has decided on a wide range of reforms. These cover, initially, (a) the restructuring of the two major government chartered banks, the Philippine National Bank and the Development Bank of the Philippines, and the adoption of safeguards that will ensure their viable operation on a competitive commercial basis without special privileges; (b) the provision of appropriate mechanisms for the disposition of non-performing accounts of the DBP and PNB; and (c) the divestment of six government-acquired banks.

The restructuring of the two government banks is being formulated and we expect the details of the reform and a schedule for its implementation to be in place by September 15, 1986. The reform is being designed according to the following principles: (a) both DBP and PNB will be reduced in size and appropriate programs for the reductions in organization, branches, and personnel will be drawn up; (b) all tax privileges will be withdrawn; (c) public deposits will be restricted to working balances with the PNB and appropriate liquidity reserves will be required; (d) there will be no government guarantees extended on PNB and DBP operations except as required by foreign official sources; (e) like commercial banks, and in accordance with existing Monetary Board regulations, PNB and DBP will be subject to private external audits; (f) there will be a timetable for their privatization, the first steps under which will be taken by end-1988; (g) PNB access to the Central Bank after its restructuring will be limited to normal rediscount operations; and (h) financial responsibility for any special developmental projects conducted through these banks will be borne directly by the national government budget.

An appropriate mechanism for the disposition of the non-performing assets of the government financial institutions will be established by December 31, 1986.

The six government-acquired commercial banks will be disposed of to private parties as soon as possible but not later than mid-1988.

32. Sugar and Coconut Sector Reforms

The change of Government has accomplished the major objectives of the structural reform programs for the coconut and sugar sectors with respect to dismantling the monopolies and restoring the primacy of free private enterprise. Future reforms will be directed toward completion of the reorganization of these industries, improving productivity and encouraging diversification, especially for the benefit of the smaller farmers.

For the sugar sector, the following measures are intended:

(a) Completion of the reorganization of the regulatory framework. The Sugar Regulatory Administration (SRA) was created by Executive Order No. 18, replacing the Philippine Sugar Commission (PHILSUCOM), which was abolished. The SRA is primarily intended to regulate production, and will concentrate on this function. It will report to the Ministry of Agriculture and Food.

(b) Establishment of completely free markets for both domestic and export sales. PHILSUMA's exclusive marketing authority will extend only up to the 1985-86 crop year.

(c) Production will be regulated by a system of freely tradable quotas, supported by selective closures of mills that will take effect beginning the crop year 1987-88.

(d) Audits of the previous sugar regulatory organizations will be completed. Operations of the new Sugar Regulatory Administration will be subject to the normal auditing procedures of the Commission on Audit.

(e) Financing policies for crop and operational loans shall be formulated and announced not later than one month before the start of milling of the 1986-87 crop by the respective financing banks.

33. For the coconut sector, the reform measures already implemented include the following: the export ban on copra was lifted by Executive Order No. 9 dated March 10, 1986; the UNICOM monopoly on exports of coconut oil has been dismantled, and direct exports by non-members of

the UNICOM group now account for more than half of coconut oil exports; and as part of the Tax Reform Program export duties on coconut products were abolished by Executive Order No. 26 dated July 1, 1986.

In addition, we intend to implement the following measures:

(a) An improved replanting, rehabilitation and intercropping program, aimed at increasing the incomes of small farmers and maintaining the Philippine share in the world market, has been developed and the decision on the scale and modalities of implementation will be made on or before September 1, 1986. We expect that this program will ensure the maintenance of the Philippine share in the world vegetable oil market.

(b) The board of the Philippine Coconut Authority will be reconstituted to have eleven members, and will have a government majority. PCA will report to the Ministry of Agriculture and Food. This new organization will be completed by August 31, 1986.

(c) The ban on additions to coconut and processing capacity will be lifted effective August 31, 1986. Although the government plans selective closures of the mills under its control because of substantial industry overcapacity, private investment will not be restricted.

(d) With respect to audit and disclosure, the COA audits requested by PCA on operations associated with levy funds are almost completed. Since the levy has been abolished and PCA no longer has access to private funds, it is felt that normal government audit procedures will adequately safeguard future operations.

34. Other Agricultural Reforms

We have reviewed existing policies and procedures in relation to rice, wheat, fertilizer and the state trading of feedgrain, particularly in relation to the objectives of the reforms in these areas that were specified in the course of 1985 but were not effectively implemented in all cases. We have therefore now taken the following measures that seek to implement the reform: (a) liberalized the import of wheat; (b) effectively liberalized the imports of urea, potash and ammonium sulphate fertilizer by eliminating all prior import permit approvals and for other fertilizer grades liberalization is under discussion; (c) we have abolished the NFA import monopoly on corn and have decide to abolish the import monopoly on rice and we will use an open tender system when imports are to be undertaken. By October 31, 1986 we will formulate and put into effect our policy regarding the domestic trade and procurement of rice and corn with the objective of eliminating administrative impediments and improving the trading environment.

35. The Philippine authorities believe that the policies and measures described in this letter are adequate to achieve the objectives of the

program but will take any additional measures that may become appropriate for this purpose.

FOR THE GOVERNMENT OF THE REPUBLIC OF THE PHILIPPINES

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Governor, Central Bank
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Jaime V. Ongpin
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Table 1. Philippines: Objectives of the Adjustment Program, 1985-88

	1985 Actual	1986	1987	1988
	(Annual percentage change)			
Output and prices				
Real GNP	-3.8	1.5	6-7	5-6
Consumer prices				
(end of period)	5.7	5	5-6	5
(period average)	23.1	4	5-6	5
Money and credit (end of period)				
Broad money	9.6	13	15	15
Monetary base	8.3	15 1/	16 1/	16 1/
	(As percent of GNP)			
Public finance				
Public investment	3.5	5.0	5.0	5.0
National government deficit	1.9	4.4	2.4	2.0
14 monitored corporations' deficit	1.4	2.3	1.6	1.3
Public sector borrowing requirement 2/	2.6	5.5	2.9	2.6
External				
Current account surplus/ deficit (-) 3/	--	0.9	-1.2	-2.0
	(In billions of U.S. dollars)			
Gross official reserves (end of period)	1.1	2.4	2.7	2.8
(in months of imports of goods and services)	(1.6)	(3.5)	(3.5)	(3.5)

Source: Data provided by the Philippine authorities.

1/ Growth rates are calculated using the averages of the 10-day test periods.

2/ National government deficit plus deficit of monitored corporations less national government transfers to the monitored corporations.

3/ Including receipts under the Economic Support Fund.

Table 2. Philippines: Quantitative Limits on Domestic Financial Policies, 1986-87

(In billions of pesos)

	1986			1987
	June 30 Ceiling	Oct. 31 Ceiling	Dec. 31 Ceiling	March 31 Ceiling
Monetary base	43.0	47.5	51.0 1/	50.8 1/
Public sector borrowing requirement (cumulative from January 1)	13.8	29.3	34.5 2/	5.0
Central Bank credit to PNB 3/	3.0	3.0	3.0	3.0

Source: Based on the discussions with the Philippine authorities.

1/ The ceilings will be adjusted downwards (upwards) to reflect any reduction (increase) in the reserve requirement on deposit money banks. In addition, the limits will be adjusted upward by the amount that NIR exceeds the program floors up to a maximum of P 2.0 billion. The excess of NIR over the floor level will be converted into pesos at P 18.002/US$1.

2/ The December 31 ceiling will be revised downward: (a) to the extent that national government revenue exceeds the targeted ₱ 86.5 billion in 1986 and (b) to the extent that implementation of the investment program falls short of budgeted capital outlays of ₱ 14.7 billion in 1986.

3/ Excluding eligible rediscounting.

PHC cli6phtb03 8-06-86

Table 3. Philippines: Quantitative Limits for the External Sector, 1986-87

(In millions of U.S. dollars)

	1986			1987
	June 30 Ceiling	Oct. 31 Ceiling	Dec. 31 Ceiling	March 31 Ceiling
External sector				
Net international reserves of the monetary authority (floor) 1/	-1,104	-1,269	-908	-778
Short-term external debt 2/	8,787 3/	9,095	9,050	9,050
Approvals of external borrowing with maturities of 1-12 years 4/	...	1,400	1,400	1,400
Approvals of external borrowing with maturities of 1-5 years 4/	...	300	300	300

Source: Based on the discussions with the Philippine authorities.

1/ Floors will be adjustable for deviations on each of the test dates from the specified assumptions on new foreign disbursements from commercial banks and official sources, Central Bank liabilities under the trade facility and Circular 1091, and rescheduling.

2/ The ceiling will be adjustable for any increase (from the end-1985 level of US$ 3,615 million) in domestic commercial bank liabilities that is matched by an increase in short-term placements by the banks with non-residents.

3/ Preliminary.

4/ Cumulative approvals from July 1, 1986 onward of all public and private sector foreign borrowing in the specified maturities, excluding reserve liabilities of the banking system and concessional loans (i.e., with a grant element of 25 percent or more).

ATTACHMENT I

PHC cli6phtb04 8-06-86

Table 4. Philippines: Estimated Revenue Impact of Tax Reform Package, Second Half of 1986 and 1987

(In millions of pesos)

Measure	Revenue Impact 1986 Second Half	Revenue Impact 1987 Full Year
I. Individual income tax		
1. Partial shift from schedular to global income tax	1/	1/
2. Apply uniform rate structure of 0-35 percent to business incomes	0	-527
3. Apply ceilings on selected allowable business deductions	0	200
4. Apply uniform "final" tax of 20 percent on interest and passive incomes, other than dividends to which gradually declining "final" rates will apply	150	300
5. Raise personal exemptions to avoid taxing income below "poverty line"	-182	-410
6. Adopt separate taxation of incomes of married couples	-200	-600
II. Corporate income tax		
7. Apply uniform rate of 35 percent	125	500
8. Apply ceilings on selected allowable deductions	170	684
9. Exempt inter-corporate dividends	-14	-30
III. Motor vehicle fees		
10. Rationalize motor vehicle registration fees other than for public transportation	0	1/
IV. Sales tax		
11. Rationalize tax rates to only three levels, 10, 20, and 30 percent	0	0
12. Remove all tax exemptions	0	0
13. Disallow "deemed" paid taxes as tax credits	0	0
14. Phase-out turnover tax and replace with value-added tax in 1988	0	0
V. Excise duties		
15. Convert all excise taxes to ad valorem rates and increase taxes on: cigarettes	1,816	5,220
beer	278	700
16. Levy 5-20 percent excise tax on motor vehicles as maximum sales tax rate is lowered to 30 percent	0	0
VI. Real property tax		
17. Adjust present (1978-based) taxable values to 1984 values	0	71
VII. Travel tax		
18. Exempt contract workers	-51	-100
VIII. Export duties		
19. Abolish all export duties except on logs	-358	-700
IX. Import duties		
20. Move from HCV to CIF basis of import taxation (except where Customs exercises right to use higher HCV)	75	300
21. Impose minimum 10 percent duty on imports zero-rated in the Tariff Code	80	150

Table 4. Philippines: Estimated Revenue Impact of Tax Reform Package, Second Half of 1986 and 1987 (concluded)

(In millions of pesos)

Measure	Revenue Impact 1986 Second Half	Revenue Impact 1987 Full Year
X. Miscellaneous taxes		
22. Rationalize tax rates on gambling activities, e.g., casinos, jai-alai, lotteries, etc.	1/	1/
23. Integrate casino, tourist and other funds into the General Fund	0	0
XI. Exemptions and incentives		
24. Withdraw tax and duty exemptions outside of the BOI system, EPZA and those under international contracts and replace, where necessary, with subsidies 2/	1,600	7,500
25. Impose uniform franchise tax and withdraw income tax exemptions	45	180
Total: Policy reform measures	3,534	13,438
XII. Tax Administrative Measures		
26. Tax amnesty on income and other internal revenue taxes 3/	1,040	0
27. Tax amnesty on real property tax	222	0
28. Tax amnesty on repatriation of foreign assets	0	0
29. Compromise agreements on disputed assessments and delinquent accounts 4/	1,040	0
30. Raise BIR incentives 5/	3,200	0
Total: One-time administrative measures	5,502	0
Memorandum Item:		
Revenue impact of import liberalization 6/	825	2,750
Revenue impact of increased taxes on fuels and oils (effective May 22)	494	1,000

1/ Unestimated but positive.
2/ The authorities have estimated the full year of revenues foregone from non-BOI incentives at P 7.5 billion, which includes the value of import tax exemptions of certain government corporations. About P 1.6 billion and P 7.5 billion have been roughly estimated as the amount of revenues which will be foregone in the remainder of 1986 and 1987 if such incentives continued. If not, the revenues will go up by as much as said amount. On the expenditure side, initially the same amounts may have to be provided as subsidies to achieve "transparency."
3/ Targeted impact based on the first income tax amnesty in 1973 which yielded P 0.9 billion.
4/ This represents around 10 percent of the value of unpaid taxes with pending court litigations.
5/ Targeted increase in revenue yield on account of improvements in efficiency and changes in BIR incentive scheme. This target is equivalent to 1 percent of the second semester GNP.
6/ Assumes 5 percent increase (i.e., on a half year basis) in aggregate import value as a consequence of import liberalization. Tariff Commission's full year estimate was about P 10.5 billion.

PHC:csr6phatIa (8/14/86)

September 15, 1986

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
700-19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Larosiere:

The attached Memorandum on Economic Policy of the Government of the Philippines outlines the policies which we will implement to regain growth, preserve stability, and restructure our economy. In connection with the adoption of these measures, the Government requests a stand-by arrangement for 18 months in an amount equivalent to SDR 198 million. We are also requesting a purchase under the compensatory financing facility of SDR ... million.

The Philippine authorities will remain in close contact with the Fund staff on developments and progress in implementing these policies. The Philippines will be pleased to invite the Fund to review the country's economic developments and progress in implementing the program, in accordance with the policies of the Fund, not later than June 1, 1987, and December 1, 1987. The Philippines will consult with the Fund on the adoption of any measures that may be appropriate in accordance with the policies of the Fund on such consultations.

Sincerely yours,

Jose B. Fernandez, Jr.
Governor, Central Bank
of the Philippines

Jaime V. Ongpin
Minister of Finance

MJA:md (8/19/86:12:00 PM)

PHILIPPINES--FISCAL DEFICIT IN 1986

ETR Position

ETR is concerned that the proposed fiscal policy may not be consistent with the lowering of the real interest rate and the real exchange rate, both of which are essential, in conjunction with import liberalization and other structural reforms, to provide for a recovery based on competitive private sector activity. The program incorporates sharp reversals in the monitored PSBR (paralleled by larger deficits on the consolidated public sector deficit) over a period of only 18 months. The PSBR was estimated at 2.6 percent of GNP in 1985, and is to rise to 5.5 percent in 1986 (₱ 34.5 billion), with a targeted reduction to 2.9 percent in 1987 (assuming a very large rise in nominal GNP in 1987). In the second half of 1986, the PSBR is allowed to rise by 50 percent in nominal terms, from ₱ 13.8 billion in the first half (4.4 percent of GNP on an annual basis) to ₱ 20.7 billion (6.6 percent of GNP on an annual basis). The domestic financing of the PSBR increases as a percentage of GNP from 1.5 percent in 1984 to over 3 percent in 1985 and to 5.5 percent in 1986, necessitating sizeable increases in public securities sales at market interest rates. In view of apparent liberal margins on the revenue and expenditure sides of the budget, ETR would urge a reduction of the 1986 PSBR by ₱ 4 billion or about 1/2 percent of GNP.

PHILIPPINES--FISCAL DEFICIT IN 1986

ASD and FAD Position

While ASD and FAD would also have preferred a smaller national government (and public sector) deficit in 1986--as it would have given greater latitude for the lowering of interest rates--they have accepted the deficit negotiated as part of the letter of intent for the following reasons:

1. The fiscal deficit (4.4 percent of GNP for 1986 as a whole) is still consistent with the balance of payments and price objectives of the program while also seeking to stimulate growth through a strengthened investment program. It therefore strikes a difficult, but broadly acceptable, balance between conflicting concerns.

2. The proportionately higher deficit in the second half-year results from the temporary suspension of expenditure releases in the second quarter while the expenditure program was being reoriented by the new government. While we believe that the full extent of the projected investment level will not be realized, due to absorptive and other constraints, and therefore the deficit may be less than presently projected, the authorities were not prepared to pre-judge their capacity to implement the investment program agreed with the World Bank.

3. The domestic impact of the deficit is considerably less than apparent, given the substantial debt repayments financed by budgetary resources. The calculations point to an effective domestic deficit of only 1 percent of GNP in 1986, a limited fiscal stimulus. Moreover, despite the increased public sector financing requirement, private sector credit is still programmed to expand by 10 percent in the second

half of 1986 and may be further supplemented by repatriated capital inflows.

4. Any reduction at this stage in the projected 1986 national government deficit would involve either: (i) re-opening the tax reform package which we have judged to be fully satisfactory and, after approval by the President, is now being implemented. Such a step would be detrimental to the overall package already agreed, to public confidence, and to our credibility with the authorities; or (ii) revising the investment and maintenance expenditure programs which had been agreed by the authorities with the World Bank. (The stand-by paper will contain the Bank's assessment.) This would also be a difficult exercise as it would be seen as a step back from the growth objective of the program.

5. Given the uncertainties in 1986 at this late stage, the emphasis of the program is for a substantial budgetary adjustment in 1987 (to 2.4 percent of GNP) which is to a much greater extent within the control of the authorities than 1986. Such an adjustment implies a timely withdrawal of the fiscal stimulus in order to provide room for a sustained private sector expansion.

(In any event, the uncertainties that affect the 1986 budget outcome work, on balance, toward a smaller deficit. First, as pointed out above, the expenditure program may not be fully implemented and there are new provisions that will prevent its reallocation to other categories. Second, there is a revenue contingency reserve of ₱ 2 billion and a provision that if revenues exceed the target, the deficit would be reduced correspondingly. The PSBR for end-1986 would be adjusted accordingly.)

cb60818ph1 ATTACHMENT V

TO - MR. JAIME V. ONGPIN, MINISTER OF FINANCE, MANILA, PHILIPPINES
- MR. JOSE B. FERNANDEZ, JR., GOVERNOR, CENTRAL BANK OF THE PHILIPPINES, MANILA, PHILIPPINES.

WE HAVE REVIEWED THE ECONOMIC PROGRAM THAT WAS DISCUSSED WITH THE RECENT MISSION AND ALSO THE DRAFT MEMORANDUM ON ECONOMIC POLICIES THAT WAS NEGOTIATED BY THE MISSION. WE BELIEVE THAT THE BALANCE IN THE PROGRAM BETWEEN DEMAND MANAGEMENT POLICIES AND STRUCTURAL REFORMS IS APPROPRIATE TO ACHIEVE A RECOVERY WHILE MAINTAINING PRICE STABILITY AND A MANAGEABLE EXTERNAL POSITION. THE FULL IMPLEMENTATION OF THE STRUCTURAL ELEMENTS OF THE PROGRAM WILL BE ESSENTIAL IN ENSURING THAT THE RECOVERY WILL BE SUSTAINED.

IN LIGHT OF THIS, I WOULD LIKE TO STRESS THE IMPORTANCE OF TWO OUTSTANDING ISSUES AND URGE THAT YOU MAKE AS MUCH PROGRESS AS POSSIBLE IN ADDRESSING THEM DURING THE COMING DAYS. FIRST, WE FOLLOW WITH INTEREST YOUR DISCUSSIONS WITH THE WORLD BANK ON THE REFORM OF THE GOVERNMENT FINANCIAL INSTITUTIONS AND WE AWAIT WORLD BANK ASSURANCE THAT THE ESSENTIAL DETAILS, IN LINE WITH THE REFORM PRINCIPLES OUTLINED IN YOU DRAFT MEMORANDUM ON ECONOMIC POLICIES, ARE IN PLACE. SECOND, WE WOULD HOPE THAT THE HEARINGS PRESENTLY BEING CONDUCTED ON THE FUTURE COURSE OF IMPORT LIBERALIZATION POLICY WILL RESULT IN A RESUMPTION OF THE LIBERALIZATION ESSENTIAL TO THE OUTWARD LOOKING STRATEGY THAT IS PART OF THE PROGRAM. AS YOU KNOW, IT HAS BEEN OUR POSITION THAT THE REMAINDER OF THE ITEMS SCHEDULED FOR LIBERALIZATION BY APRIL 1986 SHOULD BE LIBERALIZED PROMPTLY.

ONCE WE HAVE RECEIVED ASSURANCES THAT SUFFICIENT PROGRESS IN THE TWO ABOVE AREAS HAVE BEEN MADE, MANAGEMENT WILL BE PLEASED TO ANNOUNCE ITS ACCEPTANCE OF THE PROGRAM AND RECOMMEND IT FOR EXECUTIVE BOARD CONSIDERATION. WE WOULD HOPE THAT THIS PROCESS WILL BE COMPLETED IN EARLY SEPTEMBER.

YOURS SINCERELY

RICHARD D. ERB

ACTING MANAGING DIRECTOR

INTERFUND

INTERNATIONAL MONETARY FUND

N

TO : Mr. Narvekar August 15, 1986

FROM: Anoop Singh

I have asked David Burton to join us on Monday for the Philippines seminar. I hope that this is OK by you.

cc: Mr. Neiss

INTERNATIONAL MONETARY FUND

MR BRAU 8/14

Ed, you asked to-day why they are not moving on liberalization. Here is a partial answer

H

Hubert Neiss

Thursday, August 14, 1986 — BusinessDay

IMP LIB

Coalition to push for protectionism

Just about all the vital sectors of the economy — management, labor, farmers, consumers, and even the cause-oriented groups — got together formally yesterday at the Club Filipino to draw attention to a unity they "spontaneously" forged, a unity which is foreseen to sound the death knell of the remaining unimplemented portions of the import liberalization program.

The group calls itself the "Coalition for a Constitutional Provision on Industrialization, Economic Protectionism and Filipinization of the Economy," a name that reflects its espoused cause.

The coalition's press release described the grouping as a "formidable union of forces representing all sectors of Philippine society."

The group yesterday sent a letter-petition to Constitutional Commission president Cecilia Muñoz-Palma pleading for its cause as "an opening salvo." Mass actions are also slated to call further attention to the coalition's objective.

PROPOSAL. The coalition wants the new Constitution to contain the following provision: "The State shall promote the full and rapid industrialization of the economy to generate mass employment and for this purpose shall adopt, among others, a policy of direct and indirect protectionism that will preserve and ensure the domestic market for local industries as well as for agricultural and other sectors of the economy.

"The State shall at all times ensure that the economy is under the control of Filipinos and that industries deemed vital to national security do not fall under the control of non-Filipinos."

Raul T. Concepcion, chairman of the Philippine Electrical, Electronics and Allied Industries Federation in which capacity he signed the letter to Muñoz-Palma, explained that "notwithstanding what (Economic Planning Minister Solita) Monsod has said, import liberalization is an IMF (International Monetary Fund) condition." If the industrialization provision is in the proposed charter, he said, then the issue can be referred to the people in a plebiscite "and the IMF can no longer impose its will on us."

In its letter to Muñoz-Palma, the coalition referred to "powerful forces who have a vested and historical interest in seeing this country preserved as a non-industrial economy. As long as industrialization and economic protectionism are not elevated as constitutional principles, these forces will continue to succeed, as they have long succeeded, in suppressing our industrialization."

Meneleo Carlos, president of Resins, Inc. and a representative of the Philippine Chamber of Commerce and Industry (PCCI), also hit the "very many foreign institutions" which have "subverted" Philippine efforts to industrialize as he expressed the hope that with the coalition's formation, "more teeth" will be given to the country's desire to industrialize.

"We have been fighting import liberalization for so long and all that time our efforts have been subverted. We know what scheme the IMF-World Bank has — it is chopping away at all things we produce. It has already cut into some of our agricultural products. It is time we put our foot down on this and take our industrialization program more seriously, so I'm happy that we've finally taken this move," Carlos said.

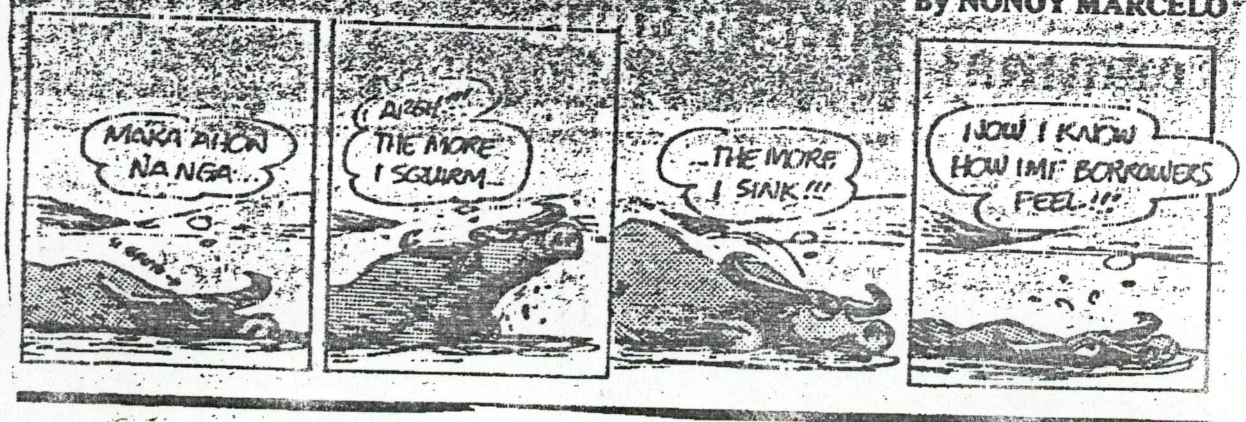
LABOR. The Kilusang Mayo Uno was also represented by its chairman Rolando Olalia who disclosed that he was "one of the first" to sign the letter to Muñoz-Palma, recalling that the KMU has already proposed to the Con-Com a policy "genuine nationalist industrialization." The problem is, he poin out, that "nationali are considered as "c mmunists," "*bagama't he sa atin ang gan* (although none of us that)."

Asked by *Business* whether its espou support for industrial tion does not run cou to the damaging eff of the rash of stri allegedly led by his o nization, Olalia rep that the KMU does " have the monopoly strikes." Most are led the independent uni and TUPAS (Trade ions of the Philipp and Allied Services), said, referring to latest statistics of labor ministry.

Thursday, August 14, 1986 — BusinessDay

TISOY

By NONOY MARCELO



BULLETIN, THURS., AUG. 14, 1986

AROUND THE NATION

Industrialization urged

A coalition of labor, agriculture, and business sectors and various cause-oriented groups sought yesterday the industrialization of the Philippine economy through Filipinization and economic nationalism.

In a letter to Constitutional Commission (Con-Com) President Cecilia Muñoz Palma, the newly organized coalition asked that a provision to this effect be included in the new constitution.

The movement explained that the existing problems on poverty and unemployment could be primarily remedied through the full and rapid industrialization of the economy.

Nationalist economist Alejandro Lichauco said that it is necessary for the new government to make the

MPLIB

'86.08.14 14:31 IMF MANILA 63-2-5163081 01

Fax No. 8/8-86

INTERNATIONAL MONETARY FUND

August 14, 1986

ORIG: ASD

CC: ETR

cc: Div.

TO : Mr. Hubert Neiss, ASD

FROM: John Karlik

JK

SUBJECT: Import Liberalization

A nationalistic, autarkic drive for industrialization may be gathering strength.

Please see the attached articles. The Constitutional Convention is not dominated by any one point of view, and today's fringe group can easily have an impact.

727425

Attachments

RECEIVED
1986 AUG 14 AM 11:34
ASIAN DEPARTMENT

RECEIVED
IMF CABLE ROOM
1986 AUG 14 AM 7:45

PRN cc: HN DG

Office Memorandum

N/

To: Mr. Singh August 11, 1986

From: E. Decarli ED

Subject: Philippines--Letter of Intent

As a general comment, the programmed increase in the monetary base (15 percent for 1986 and 16 percent for each of the following two years) would appear to be rather large given the objective of inflation (5-6 percent annual rate of increase in consumer prices per year), particularly for 1986 when little growth is expected in real GNP. Moreover, given the cautious stand on further import liberalization, the intention to allow the salaries of civil servants to grow in real terms and the rather optimistic assumptions about real GNP growth in 1987 and 1988 (5-7 percent), it would appear that an increase in inflation to about 10 percent would not be unlikely.

Specific comments on the Letter are the following:

1. The last sentence of paragraph 8 is confusing. It is not clear which concept of fiscal deficit will be reduced to ₱ 25.9 billion. Also, the figures for the public sector borrowing requirement of Table 2 do not seem to correspond to the concept of fiscal deficit in paragraph 8.

2. In Table 2, the adjustment to the ceilings on the monetary base, in case of changes in reserve requirements (footnote 1), needs to be spelled out. Is the adjustment covered in a technical memorandum? Also, shouldn't footnote 1 apply to the September (or October) ceiling?

3. Also in Table 2, the "eligible rediscounting" of footnote 2 needs to be defined, which could be done in a separate technical memorandum. Is there any connection between this footnote and the sentence starting in the penultimate line of page 9?

cc: Mr. Habermeier
Mr. Hood
Mr. Tanzi
Mr. Gianviti
Mr. Brau

Office Memorandum

TO: The Acting Managing Director | August 11, 1986

FROM: P.R. Narvekar PRN

SUBJECT: Philippines: Debt Equity Conversion Scheme

The Monetary Board of the Philippines has recently approved a scheme that provides for the conversion of Philippine external debt into designated long-term equity investments. The authorities see this scheme as a major plank of the strategy to revive foreign investor interest, investment and activity in the Philippines and help the domestic recovery. It is targeted at overseas private investors who would be allowed to convert debt purchased in secondary markets for the full peso equivalent of the face amount of the obligation.

The authorities have sought to pattern the scheme after similar arrangements adopted elsewhere (Chile). 1/ The scheme is also described in the draft letter negotiated by the recent mission. (We will be sending the letter of intent to you later this week after comments have been received from other departments.)

For your information.

cc: Mr. Gianviti
Mr. Brau
Mr. Brown (on return)

1/ The scheme is similar to the first option under the Chilean scheme--equity investment with remittance rights. But it is the second option in the Chilean scheme--investment without remittance rights--that has attracted more investments because of the broader coverage of allowable transactions.

INTERNATIONAL MONETARY FUND

August 8, 1986

Mr. Rye/Mr. Romualdez

As requested, attached is the draft of the Letter of Intent that reflects the final days discussions in Manila.

cc: Mr. Narvekar (without attachment)

AS

Anoop Singh

Mr. Neiss

Office Memorandum

TO: Mr. Hicks

August 6, 1986

FROM: David Goldsbrough DG

SUBJECT: Philippines: Most Recent Projections for the Macro-Economic Framework and the Balance of Payments

As you requested, I attach tables showing our most recent projections for the balance of payments and the general macroeconomic framework. These should be treated as confidential.

Attachments

cc: Mr. Neiss (without attachments)
Mr. Singh (without attachments)

M. Neiss

Office Memorandum

CONFIDENTIAL

To: Mr. Tanzi

August 6, 1986

From: Ved P. Gandhi VPG

Subject: Philippines--Back-to-Office Report

I participated in a Use of Fund Resources mission to the Philippines (July 16-August 2, 1986) led by Mr. Hubert Neiss. The negotiations for an 18-month stand-by program were completed and a draft ad referendum letter of intent agreed with the authorities. The program focuses on many areas of structural reform and creates conditions for quick economic recovery, after many years of stagnation, without foresaking the benefits of past stabilization efforts. One major missing element of the program is the temporary delay in the implementation of the import liberalization program according to the previously agreed schedule, for which "public hearings" have been initiated. It is, therefore, proposed that the management approval on the agreed program be delayed until mid-September when (a) we should be able to make an informed assessment of the authorities' intentions on the import liberalization program, and (b) the authorities would have reached an agreement with the World Bank on a timetable for the specifics relating to the reform of Government Financial Institutions (GFIs) under its Economic Recovery Loan. So far as the fiscal component of the stand-by program is concerned, the developments are on the whole heartening.

1. Structural (fiscal) reforms

As you are well aware, three major problems have plagued the government budget in the past: stagnant tax ratio resulting from the inelasticity of the tax system; growing deficits of the large government enterprise sector, with the latter's ever-increasing reliance on the government budget; and the massive (₱ 140 billion) nonperforming assets of the GFIs financed in the past by government guaranteed foreign debts and the resultant burden of GFIs' external debts on the present and future government budgets.

In its negotiations, the mission attempted to tackle all these problems relatively successfully. Annex I, attached to this report, quotes relevant paragraphs from the draft letter of intent and provides the necessary details of the agreements reached.

Briefly, a substantial tax reform package, aimed at providing incentives and achieving a multiplicity of other economic objectives, has been approved by the Cabinet and the supporting executive orders are being gradually signed. The tax reform package is expected to yield ₱ 3.5 billion in the second half of 1986 and ₱ 13.5 billion in 1987 (see Table 1). Much of the revenue increase results from the elimination of tax exemptions and increases in the rates of excise duties (Table 2 provides details of the latter). The authorities have also enacted a few one-shot administrative measures, including tax amnesties and collection of arrears, and these are expected to generate an additional ₱ 5.5 billion in revenue during the second half of 1986. (The mission has, however, encouraged the authorities to discount the revenue impact of tax administrative measures by at least ₱ 2 billion.) Finally, the authorities have announced replacement of the existing sales tax by a value-added tax, effective January 1, 1988, and have requested our technical assistance in this connection. They have also initiated studies on other tax issues in anticipation of implementing yet another tax reform package in 1988.

Reforms have also been initiated in respect of the nonfinancial government corporate sector and their implementation will start at the time of the first program review. In particular, the authorities intend to recover the cost of new capital they provide to government corporations, levy a charge on outstanding loan balances, insist that these corporations improve their costing procedures and billing and collection efficiency. Measures will also be instituted to rationalize their tariff structures and expenditure programs to enhance their internal cash generation. Finally, starting in 1987, we may also see some corporations privatized and the workings of others fundamentally transformed. By their very nature, the impact of all these measures will be realized only in the medium term.

In relation to the GFIs, much of what the draft letter of intent says reflects the authorities' agreement on the essential principles of reform with the World Bank in connection with the Economic Recovery Loan. On our part, we insisted on, and got, an agreement with the authorities that the budgetary assistance to GFIs in 1987 and beyond should be limited to the latter's external debt service burden or the funding gap, whichever was lower.

2. Public sector borrowing requirements

Table 3 gives information on the projected public sector borrowing requirements and compares it with the mission brief. Tables 4 and 5 provide the necessary background data on the projected deficits of the national government and 14 monitored government corporations, respectively, and the targets of the two subsectors of the public sector specified in the mission brief. As you will notice, the projected deficit is in all cases equal to or below the amounts specified in the briefing paper, with the exception of the national government deficit for 1986, which is projected at ₱ 27.9 billion against the target of ₱ 26.2 billion in the briefing paper (Table 4). Four points need to be borne in mind in appreciating this. First, as mentioned earlier, the mission insisted, as a measure of caution, that the authorities provide a contingency reserve of ₱ 2 billion to allow for any possible shortfall in projected revenue from tax administrative measures (see Table 4). Should the tax administration measures yield the full targeted amount of ₱ 5.5 billion in 1986, the authorities have agreed that the targeted deficit for 1986 will correspondingly be reduced to ₱ 25.9 billion. Second, for 1986, the mission was obliged to accept the very large increases in capital outlays (67 percent over 1985) and maintenance and operating expenditures (63 percent over 1985) insisted upon by the World Bank in the interest of getting economic recovery underway. It was pointed out that even after these substantial increases their real levels in 1986 will be no higher than 55 percent and 79 percent of their respective 1982 levels. Third, in 1986, the GFIs would continue to need large budgetary assistance (₱ 21 billion or about one fifth of the total budget in 1986) and it is only in 1987 that their reform will have any impact on the national government budget. Finally, structural reforms of the government corporate sector will also have impact only in 1987; in the meanwhile, their burden on the budget will remain high due to large external debt payments. All these factors have imparted a kind of rigidity to the level of government expenditure in 1986 about which the mission was convinced that little can be done in the few remaining months of the current fiscal year. The mission has also reviewed with the authorities the domestic component of the projected 1986 deficit of ₱ 27.9 billion and has found it to be only ₱ 8.5 billion. This suggests that the inflationary impact of the 1986 budget deficit may not be as large. Please note in Tables 4 and 5 that the national government budget deficits as well as the deficits of monitored government corporations in 1987 and 1988 are projected to be lower than the targets specified in the mission brief.

3. Conclusion

Given the facts that (a) many structural reforms have been initiated in the fiscal area, many of which are expected to yield "dividends" primarily in fiscal 1987 and 1988; and (b) many rigidities of public expenditure have to be recognized for 1986 but which are being contained and corrected in the medium term, the envisaged public sector adjustment seems reasonable and appropriate under the circumstances.

Attachments

cc: Mr. Tait
Mr. Latham
Mr. Yandle
Mr. Neiss
Mr. Singh

1/

S:ASD tb4vg (7/30/86)

Table 1. Philippines: Estimated Revenue Impact of Tax Reform Package, Second Half of 1986 and 1987

(In millions of pesos)

Measure	Revenue Impact 1986 Second Half	Revenue Impact 1987 Full Year
I. Individual income tax		
1. Partial shift from schedular to global income tax	1/	1/
2. Apply uniform rate structure of 0-35 percent to business incomes	0	-527
3. Apply ceilings on selected allowable business deductions	0	200
4. Apply uniform "final" tax of 20 percent on interest and passive incomes, other than dividends to which gradually declining "final" rates will apply	150	300
5. Raise personal exemptions to avoid taxing income below "poverty line"	-182	-410
6. Adopt separate taxation of incomes of married couples	-200	-600
II. Corporate income tax		
7. Apply uniform rate of 35 percent	125	500
8. Apply ceilings on selected allowable deductions	170	684
9. Exempt inter-corporate dividends	-14	-30
III. Motor vehicle fees		
10. Rationalize motor vehicle registration fees other than for public transportation	0	1/
IV. Sales tax		
11. Rationalize tax rates to only three levels, 10, 20, and 30 percent	0	0
12. Remove all tax exemptions	0	0
13. Disallow "deemed" paid taxes as tax credits	0	0
14. Phase-out turnover tax and replace with value-added tax in 1988	0	0
V. Excise duties		
15. Convert all excise taxes to ad valorem rates and increase taxes on: cigarettes	1,816	5,220
beer	278	700
16. Levy 5-20 percent excise tax on motor vehicles as maximum sales tax rate is lowered to 30 percent	0	0
VI. Real property tax		
17. Adjust present (1978-based) taxable values to 1984 values	0	71
VII. Travel tax		
18. Exempt contract workers	-51	-100
VIII. Export duties		
19. Abolish all export duties except on logs	-358	-700

Table I. Philippines: Estimated Revenue Impact
of Tax Reform Package, Second Half of 1986 and 1987 (concluded)

(In millions of pesos)

Measure	Revenue Impact 1986 Second Half	1987 Full Year
IX. Import duties		
20. Move from HCV to CIF basis of import taxation (except where Customs exercises right to use higher HCV)	75	300
21. Impose minimum 10 percent duty on imports zero-rated in the Tariff Code	80	150
X. Miscellaneous taxes		
22. Rationalize tax rates on gambling activities, e.g., casinos, jai-alai, lotteries, etc.	1/	1/
23. Integrate casino, tourist and other funds into the General Fund	0	0
XI. Exemptions and incentives		
24. Withdraw tax and duty exemptions outside of the BOI system, EPZA and those under international contracts and replace, where necessary, with subsidies 2/	1,600	7,500
25. Impose uniform franchise tax and withdraw income tax exemptions	45	180
Total: Policy reform measures	3,534	13,438
XII. Tax Administrative Measures		
26. Tax amnesty on income and other internal revenue taxes 3/	1,040	0
27. Tax amnesty on real property tax	222	0
28. Tax amnesty on repatriation of foreign assets	0	0
29. Compromise agreements on disputed assessments and delinquent accounts 4/	1,040	0
30. Raise BIR incentives 5/	3,200	0
Total: One-time administrative measures	5,502	0
Memorandum Item:		
Revenue impact of import liberalization 6/	825	2,750
Revenue impact of increased taxes on fuels and oils (effective May 22)	494	1,000

1/ Unestimated but positive.

2/ The authorities have estimated the full year of revenues foregone from non-BOI incentives at P 7.5 billion, which includes the value of import tax exemptions of certain government corporations. About P 1.6 billion and P 7.5 billion have been roughly estimated as the amount of revenues which will be foregone in the remainder of 1986 and 1987 if such incentives continued. If not, the revenues will go up by as much as said amount. On the expenditure side, initially the same amounts may have to be provided as subsidies to achieve "transparency."

2/ Targeted impact based on the first income tax amnesty in 1973 which yielded P 0.9 billion.

3/ This represents around 10 percent of the value of unpaid taxes with pending court litigations.

4/ Targeted increase in revenue yield on account of improvements in efficiency and changes in BIR incentive scheme. This target is equivalent to 1 percent of the second semester GNP.

5/ Assumes 5 percent increase (i.e., on a half year basis) in aggregate import value as a consequence of import liberalization. Tariff Commission's full year estimate was about P 10.5 billion.

Table 2. Philippines: Selected Excise Duty Dates Before and After Tax Reform (June 23, 1986)

Item	Excise Duties (In pesos) Before Tax Reform Specific	Ad Valorem	Total	After Tax Reform Specific	Ad Valorem	Total	Retail Prices (In pesos) 1/ Before Tax Reform	After Tax Reform	Average Excise Duty Rates (In percent) Before Tax Reform	After Tax Reform
I. Petroleum products										
Regular gasoline	1.575	0.988	2.563	2.604	0.684	3.288	6.780	6.550	37.80	50.35
Premium gasoline	1.490	1.077	2.567	2.489	0.787	3.276	7.150	6.900	35.90	47.47
Fuel oil	0.443	0.198	0.641	0.511	0.130	0.641	3.472	2.815	18.46	22.77
Kerosene	0.268	0.589	0.857	0.628	0.424	1.052	5.310	4.810	16.13	21.87
Diesel	0.269	0.852	1.121	0.523	0.598	1.121	5.260	4.760	21.31	23.55
II. Cigarettes										
a. Packed in 20s										
Foreign brands										
Philip Morris Menthol 100	3.400	0.078	3.478	--	4.000	4.000	7.50	8.50	46.00	47.00
Marlboro King	2.400	0.072	2.472	--	3.528	3.528	6.50	7.50	38.00	47.00
Local brands										
Mark Menthol 100	1.00	0.073	1.073	--	1.900	1.900	4.25	5.00	25.00	38.00
Bowling Green Menthol 100	1.20	0.066	1.266	--	2.011	2.011	4.50	5.25	28.00	38.00
b. Packed in 30s										
Alhambra Blanco 8030	0.150	0.019	0.169	--	0.236	0.236	2.40	2.70	11.00	12.00
Sportsman Menthol 100	0.270	0.048	0.318	--	0.585	0.585	2.90	3.30	12.00	19.00
III. Beer										
Pale Pilsen (San Miguel)	0.576	0.115	0.691	--	1.003	1.003	3.50	3.50 2/	19.74	28.66
Manila Beer	0.576	0.070	0.646	--	1.000	1.000	2.50	3.00	25.84	33.33

Table 2. Philippines: Selected Excise Duty Dates Before and After Tax Reform (June 23, 1986) (Concluded)

Item	Excise Duties (In pesos) Before Tax Reform Specific	Before Tax Reform Ad Valorem	Before Tax Reform Total	After Tax Reform Specific	After Tax Reform Ad Valorem	After Tax Reform Total	Retail Prices (In pesos) 1/ Before Tax Reform	Retail Prices (In pesos) 1/ After Tax Reform	Average Excise Duty Rates (In percent) Before Tax Reform	Average Excise Duty Rates (In percent) After Tax Reform
IV. Compound Liquors 3/										
Andy Player Special	1.209	0.365	1.574	1.209	0.365	1.574	10.00	10.00	15.74	15.74
White Castle 5 year old	1.200	0.333	1.533	1.200	0.333	1.533	9.00	9.00	17.03	17.03
Ginebra San Miguel	1.120	0.258	1.378	1.120	0.258	1.378	9.00	9.00	15.31	15.31

Source: Data provided by Bureau of Internal Revenue.

1/ Queen's Supermarket prices.
2/ The producer has decided to fully absorb the increase in excise duty.
3/ Data on excise duties relate to 24 bottles/375 cc.

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Table 3. Philippines: Monitored Public Sector Borrowing Requirement 1/

(In billions of pesos)

	1986				1987		1988
	Jan. 1 - June 30	Jan 1 - Sept 30	Jan 1 - Oct 31 2/	Jan 1 - Dec 31	Jan 1 - Mar 31	Jan 1 - Dec 31 Indicative	Jan 1-Dec 31 Indicative
National Government Deficit (-)	11.7	26.0	26.6	27.9	4.9	17.0	15.7
plus							
Monitored Government Corporations Deficit (-)	6.3	10.0	11.0	14.3	1.9 3/	11.2	10.3
minus							
Government Assistance to Monitored Corporations	-4.2	-8.6	-8.3	-7.7	-1.9	-7.8	-5.6
Total:	13.8	27.4	29.3	34.5	4.9	20.4	20.4
~~(Briefing paper target)~~	(--)	(--)	(--)	(32.0)	(--)	(30.0)	(23.5)

Source: Data provided by the Philippine authorities.

1/ Cumulative from January 1 of each year.
2/ October financing estimated as one-third of the fourth quarter.
3/ Reflects one quarter of the agreed additional (P 1.5 billion) adjustment on the part of the corporations./

Table 4. Philippines: National Government Program Targets, 1986-88

	1985 Actual	1986 April estimate	1986 Program target	1987 Program Target	1988 Indicative Target
	(In billions of pesos)				
Revenue	68.9	80.3	86.5	102.2	111.5
Tax revenue	61.1	69.0	75.8	90.6	99.4 1/
Of which:					
Impact of tax reform	(--)	(--)	(3.5) 2/	(13.4) 2/	(13.4) 1/
Impact of tax administrative measures	(--)	(--)	(5.5) 2/	(--) 2/	(--)
Provision for revenue shortfall	(--)	(--)	(-2.0)	(--)	(--)
Expenditure and net lending	80.1	115.3	114.4	119.2	127.2
Of which:					
Capital outlays	(8.8)	(13.9)	(14.7) 3/	(17.1) 3/	(12.3)
Maintenance and operating expenditures	(13.2)	(18.9)	(21.5) 3/	(25.3) 3/	(28.7)
Assistance to GFIs	(11.3)	(23.4)	(20.9)	(9.5) 4/	(9.0) 4/
Assistance to major government corporations	(3.5)	(9.0)	(7.7) 5/	(7.8) 5/	(5.6)
Deficit (-)	-11.2	-35.0	-27.9 6/ 7/	-17.0 6/	-15.7
Briefing paper target	(--)	(--)	(-26.2)	(-20.0)	(-15.7)
Financing					
Foreign (net)	(-0.3)	(-0.2)	(8.0)	(9.4)	(4.3)
Domestic (net)	(11.5)	(35.2)	(19.9)	(7.6)	(11.4)
Memorandum item:					
GNP	595.0	631.0	631.0	709.0	789.0
	(In percent of GNP)				
Revenue	11.6	12.7	13.7	14.4	14.1
Tax revenue	(10.3)	(10.9)	(12.0)	(12.8)	(12.6) 1/
Expenditure and net lending	13.5	18.3	18.1	16.8	16.1
Capital outlays and maintenance and operating expenditures	(3.7)	(5.2)	(5.7) 3/	(6.0) 3/	(5.2)
Assistance to GFIs	(1.9)	(3.7)	(3.3)	(1.3) 4/	(1.1)
Assistance to major government corporations	(0.8)	(1.4)	(1.2)	(1.1)	(0.7)
Deficit	-1.9	-5.5	-4.4	-2.4	-2.0
Domestic (net)	(1.9)	(5.5)	(3.2)	(1.1)	(1.4)

Source: Data provided by the Philippine authorities.

1/ Does not include the revenue impact of planned replacement of sales tax by value-added tax.
2/ See Table 1 for details of tax reform.
3/ These amounts have been assessed by the World Bank to be essential and desirable.
4/ In 1986, external debt service burden of GFIs is ₱ 11.2 billion. In 1987 and 1988, assistance to GFIs will be limited to their external debt service after rescheduling or funding gap, whichever is lower.
5/ About ₱ 5.0 billion of this reflects the external debt service burden of government corporations financed by the national government. Their total external debt service burden is about ₱ 30.0 billion.
6/ About 70 percent of the deficit in 1986 is foreign-based. In 1987, domestic-based components of the budget are estimated to have a surplus of ₱ 10 billion.
7/ Should the shortfall of ₱ 2.0 billion in revenue not materialize, the deficit is targeted to be ₱ 25.9 billion.

Table 5. Philippines: Monitored Government Corporations Program Targets, 1986-88

(In billions of pesos)

	1985	1986		1987	1988
	Actual	April estimate	Program target	Program Target	Indicative Target
Total receipts	56.8	--	44.9	47.8	--
Current expenditures	52.6	--	45.5	44.9	--
Internal cash generation	4.2	neg.	-0.6	2.9	4.2
Capital expenditures	12.3	14.8	13.7	15.5	16.0
Deficit (-)	-8.1	-14.8	-14.3	-12.6	-11.8
Deficit after policy changes	(-8.1)	(-14.8)	(-14.3)	(-11.2) 1/	(-10.3) 1/
Briefing paper target	(--)	(--)	(-14.1)	(-14.0)	(-12.0)
Financing					
External (net)	-2.4	-1.6	-2.2	-1.3	-0.5
Domestic (net)	10.5	16.6	16.5	12.5	10.8
Of which: National government	(4.7)	(9.0)	(7.7)	(7.8)	(5.6)
Memorandum item:					
Deficit as percent of GNP	1.4	2.4	2.3	1.6	1.3

Source: Data provided by the Philippine authorities.

1/ Policy changes agreed to in the latest draft letter of intent are assumed to reduce deficits in 1987 and 1988 only.

1. Tax reform

ANNEX I

The Government has approved and is implementing a comprehensive Tax Reform Program comprising 29 measures, including both long-term structural reform measures and one-time tax amnesties. The long-term measures are aimed primarily at improving equity and promoting growth and efficiency. These include measures to globalize taxes on all incomes except passive incomes; raise personal exemptions under the income tax to avoid taxing incomes below the poverty level and provide for their future indexation; reduce and simplify business and sales taxes; abolish export taxes except on logs; reform the basis of the taxation of imports; and remove all tax and duty exemptions, with a few exceptions. The revenue measures increase taxes on beer, cigarettes and gambling, and raise the minimum import duty rate to 10 percent. Finally, there are amnesties on income and property taxes and repatriation of foreign assets

This program is so comprehensive that few further structural improvements are necessary in the near term. The following are intended to be undertaken:

(a) a change in the basis of customs valuation from home consumption value (HCV) to actual transaction value or CIF, with the option of using HCV if the declared CIF value is deemed unrealistic; effective not later than August 31, 1986.

(b) a series of studies on the direction of future tax reform, in particular, reviews of: (i) the timing of further globalization of the income tax; (ii) capital gains taxation; (iii) tax depreciation allowances; (iv) BOI and other incentives under various tax codes; and (v) property taxation. In these areas, we will consider implementing structural reforms, after prior consultation with the Fund, by end 1987, i.e., with the 1988 national government budget.

(c) The introduction of a value added tax, also with the 1988 budget, in place of existing sales and turnover taxes. We have already requested the Fund for technical assistance in preparing for the introduction of the value-added tax.

2. The Reform of

Non-financial public corporations. We have inherited a large and inefficient public sector that is uncompetitive, reliant on a complex network of implicit subsidies and budgetary assistance, and representative of a massive misallocation of public resources. It is the government's firm intention to subject this sector to the closest scrutiny with the objective of formulating policies that would improve productivity, minimize government intervention, and achieve maximum transparency of public sector operations. We have initiated wide-ranging actions toward this end and expect to decide upon the details of such a reform, adopt a schedule of measures, and initiate their implementation by January 1, 1987. We intend the bulk of these reforms to be implemented during the program period. Some of the initiatives underway include:

(a) We are constituting task forces to conduct comprehensive management and financial audits of five major corporations.

(b) These recommendations will focus on improvements in their collection and billing efficiencies, and the rationalization of their tariff structures and expenditure programs so as to raise internal cash generation of these and the other monitored corporations. It will be our policy to (i) charge the full cost of borrowed funds on new government net lending; (ii) consider levying a charge on outstanding net lending balances; (iii) change depreciation practices to a replacement cost basis; (iv) reflect the actual cost of foreign borrowing of these corporations in their costing and prices of goods and services; and (v) implement Executive Order 518 (Section 17) which provides that all government corporations must declare dividends equivalent to 5 percent of net earnings.

(c) The Presidential Commission on Government Reorganization has submitted a plan to the Cabinet for the rationalization and privatization of the 214 non-financial government corporations. The recommendations are to privatize 87 corporations through sale, convert 8 to private associations or foundations, abolish 38, consolidate 21, convert 14 to regular government status and retain only 46.

(d) A Task Force has been established at the Ministry of Budget and Management to review and consolidate outstanding arrears, and adopt a timetable for their settlement.

3. The Reform of Government Banking Institutions

We have inherited large government financial institutions which, particularly during the period preceding the financial and exchange crisis, were misused and whose operations resulted in a massive misallocation of resources. A very substantial portion of their assets, now estimated at $7 billion, is non-performing. The liquidation of obligations, mostly financed from external resources, will remain both a charge on public resources and a burden on the balance of payments for the next decade. The need for a thorough reform of the sector has been recognized and the government has decided on a wide range of reforms. These cover, initially, (a) the restructuring of the two major government chartered banks, the Philippine National Bank and the Development Bank of the Philippines, and the adoption of safeguards that will ensure their viable operation on a competitive commercial basis without special privileges; (b) the provision of appropriate mechanisms for the disposition of non-performing accounts of the DBP and PNB; and (c) the divestment of six government-acquired banks.

The restructuring of the two government banks is being formulated and we expect the details of the reform and a schedule for its implementation to be in place by September 15, 1986. The reform is being designed according to the following principles: (a) both DBP and PNB will be reduced in size and appropriate programs for the reductions in organization, branches, and personnel will be drawn up; (b) all tax privileges will be withdrawn; (c) public deposits will be restricted to working balances with the PNB and appropriate liquidity reserves will be required; (d) there will be no government guarantees extended on PNB and DBP operations except as required by foreign official sources; (e) like commercial banks, and in accordance with existing Monetary Board regulations, PNB and DBP will be subject to private external audits; (f) there will be a timetable for their privatization, the first steps under which will be taken by end-1988; (g) PNB access to the Central Bank after its restructuring will be limited to normal rediscount operations; and (h) financial responsibility for any special developmental projects conducted through these banks will be borne directly by the national government budget.

An appropriate mechanism for the disposition of the non-performing assets of the government financial institutions will be established by December 31, 1986.

The six government-acquired commercial banks will be disposed of to private parties as soon as possible but not later than mid-1988.

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

August 4, 1986

FROM: P.R. Narvekar PRN

SUBJECT: Philippines--Stand-by Negotiations

The mission concluded discussions on a new program last Saturday and will submit a draft Letter of Intent to you within the next two days, together with the back-to-office report.

The Philippine authorities intend to inform the press that the first step in their negotiations with the Fund has been concluded. This may have happened today.

For your information.

cc: Mr. Brown

cc: HN Div.

→ Mr. Narvekar
Mr. Neiss should use 30% when he talks about access. If there is a major problem please let me know
PDE
July 31, 1986

cc-MD
ETR
TREAS

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Philippines: Alternative Use of Fund Resources
During Proposed Stand-By Arrangement

(In millions of SDRs)

	Gross drawings	Repurchases	Net drawings	Percent of quota 1/
Stand-By 2/	225.0	225.1	-0.1	0.0
CFF	224.1	141.6	82.5	12.5
Total	449.1	366.7	82.4	12.5
Stand-By 3/	212.0	225.1	-13.1	-2.0
CFF	224.1	141.6	82.5	12.5
Total	436.1	366.7	69.4	10.5
Stand-By 4/	198.0	225.1	-27.1	-4.1
CFF	224.1	141.6	82.5	12.5
Total	442.1	366.7	55.4	8.4

1/ On an annual basis.
2/ 34 percent of quota on an annual basis.
3/ 32 percent of quota on an annual basis.
4/ 30 percent of quota on an annual basis.

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