0404

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/122

10:00 a.m., October 7, 1992

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
G. K. Arora	
	Wei B.
	G. C. Noonan
T. C. Dawson	
	V. Kural, Temporary
E. A. Evans	R. L. Knight
	E. Quattrociocche, Temporary
	S. K. Fayyad, Temporary
I. Fridriksson	
	N. Tabata
	B. Esdar
J. E. Ismael	
	P. Rubianes, Temporary
	I. Martel
	O. Kabbaj
	M. J. Mojarrad, Temporary
	T. Berrihun, Temporary
	J. Dorrington
G. A. Posthumus	
	T.-M. Kudiwu, Temporary
	R. Marino
A. Végh	A. G. Zoccali

L. Van Houtven, Secretary and Counsellor
C. P. Clarke, Assistant

1. Surveillance - Extension of Period for Reviews . . . . Page 3
2. Philippines - 1992 Article IV Consultation, and
   Review Under Stand-By Arrangement . . . . Page 4
3. Approval of Minutes . . . . Page 55
4. Executive Board Travel . . . . Page 55

Also Present
IBRD: H. Kharas, East Asia and Pacific Regional Office. Fiscal Affairs Department: J. A. Schiff. Legal Department: R. B. Leckow. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; C. V. A. Collyns, S. Kanesa-Thasan, S. C. Prowse. Secretary's Department: A. Jbili, A. Leipold. Southeast Asia and Pacific Department: L. M. Koenig, Deputy Director; S. V. Dunaway, M. J. Fetherston, C.-S. Lee, J. Lin, B. J. Smith. Treasurer's Department: C. Kelly. Advisors to Executive Directors: J. M. Abbott, L. Dicks-Mireaux, B. R. Fuleihan, A. Raza, S. von Stenglin. Assistants to Executive Directors: B. Abdullah, S. Al-Huseini, M. Blome, J. A. Costa, N. A. Espenilla, Jr., O. A. Himani, K. J. Langdon, E. H. Pedersen, R. K. W. Powell, P. Salles, T. P. Thomas, A. Törnqvist, J. W. van der Kaaij, S. Vori.

1. SURVEILLANCE - EXTENSION OF PERIOD FOR REVIEWS

The Acting Chairman recalled that the biennial review of surveillance had been tentatively scheduled for discussion in October 1992. A staff paper and background material had already been prepared for Board consideration. However, in light of recent developments in the foreign exchange and international financial markets, and calls by Governors during the Annual Meetings for a strengthening of Fund surveillance, the Managing Director said he believed that it would be useful to take some additional time to assess the implications of recent events for the Fund's surveillance tasks, particularly as they related to the industrial countries. Therefore, he proposed that the biennial surveillance review be held in January 1993, which would require an extension of the deadline for completion of the review.

In addition, the Acting Chairman continued, the Board had to observe the November 22, 1992 deadline for the review of the temporary shift in Article IV consultation cycles, with a view to returning to normal consultation cycles. If Directors agreed, that specific aspect of surveillance could be separated from the January 1993 discussion on the broader issues of surveillance. A short paper on the return to normal consultation cycles had been prepared, which could be circulated together with a draft decision for lapse of time approval (see EBD/92/240, 10/9/92).

In response to a question from Mr. Evans, the Acting Chairman stated that the paper on the temporary shift in consultation cycles was almost ready to be circulated; the associated decision on the reversion to normal consultation cycles could probably be taken on a lapse of time basis. Of course, Directors would have an opportunity to bring the matter to the Board for discussion, but he did not anticipate that a discussion would be necessary.

Mr. Posthumus remarked that he supported the Acting Chairman's proposals. In addition, Directors would have a preliminary discussion on surveillance at the forthcoming discussion on the work program, and management might want to circulate its preliminary views on the issue before the work program discussion.

The Acting Chairman said that he agreed that the work program discussion was a good opportunity to discuss surveillance in a general manner in anticipation of the January 1993 discussion. There might also be informal occasions for Directors and the Managing Director to meet to discuss various possibilities before a final paper was prepared for the January discussion.

Mr. Dawson said that he, too, agreed with Mr. Posthumus's suggestion. Of course, issues related to surveillance would be touched on in a number of other discussions as well, such as the forthcoming informal discussion on exchange rate developments and the recently scheduled discussion on the preliminary reassessment of the world economic outlook. In a sense, therefore, the biennial review itself would probably only formalize the outcome of a number of Board discussions during the coming few months.

The Executive Board then took the following decision:

In Decision No. 9499-(90/111), adopted July 11, 1990, as amended, "November 22, 1992" shall be replaced by "January 31, 1993."

Decision No. 10159-(92/122), adopted
October 7, 1992

2. PHILIPPINES - 1992 ARTICLE IV CONSULTATION, AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1992 Article IV consultation with the Philippines and the second review under the 18-month stand-by arrangement for the Philippines approved on February 20, 1991, which was extended to end-1992 on March 4, 1992 (EBS/92/153, 9/16/92; Sup. 1, 10/6/92 and Sup. 2, 10/6/92). They also had before them a background paper on recent economic developments in the Philippines (SM/92/186, 9/28/92).

The staff representative from the Southeast Asia and Pacific Department said that reserve money had averaged peso 122 billion during the first eight days of the ten-day September 1992 test period, compared with peso 120.9 billion during the first six days of the test period as reported in EBS/92/153, Supplement 1. On the basis of the first eight days of the test period, therefore, reserve money was marginally above the program target of peso 121.5 billion.

Mr. Evans made the following statement:

This meeting encompasses the 1992 Article IV consultation and the much-delayed review under the stand-by arrangement. I am also reminding Directors of the Philippine authorities' intention to seek moderate augmentation to support the closure of their Brady deal with the commercial banks and, hence, complete the financing of the program.

Since the previous program review (EBM/92/27, 3/4/92), the Philippines has held presidential, congressional, and local elections. The peaceful and democratic nature of the transition to the new Administration and legislature demonstrates a maturing democracy in the Philippines, to which the economic stabilization program has contributed. The new Administration's confirmation of that program and its plans for a market-based, growth-oriented successor are also noteworthy.

Contrary to the expectations of many, economic policies were held generally on course through the election period, and significant progress has now been made toward external viability. Monetary growth has been significantly curtailed, and inflation has been brought down and held to a single-digit rate throughout 1992 (see Annex). The external accounts have strengthened dramatically, reflecting both a reduction in the domestic savings/ investment imbalance and a rekindling of voluntary capital inflows. Underlying these developments, fiscal consolidation has been exemplary, bettering the program targets in both 1991 and, on current estimates, 1992.

These notable stabilization achievements have been neither easy, smooth, nor without cost. Economic growth has been severely constrained, and investment, both private and public, has declined. This has resulted from the uncertainty surrounding the long pre-election period and the short-term effects of the stabilization effort.

As with most elections, the Philippine experience saw some minor policy setbacks, but, overall, the policy thrust was maintained. On fiscal policy, some key revenue legislation still awaits passage and some high priority developmental capital expenditure was delayed to ensure the achievement of the fiscal targets; even so, reflecting the steady progress with improvements in tax administration, the tax/GDP ratio increased again in 1992--for the third year running--in line with the program requirements.

Monetary policy presented considerable problems. As noted above, monetary growth was severely curtailed, resulting in M3 growth being halved and base money growth falling by about two thirds. The high real interest rates generated in the process--6-9 percent at the short end--encouraged capital inflows and exchange rate appreciation, the latter contrary to the program objectives. Exporters were severely squeezed and demands for compensation escalated. The Philippine authorities formed the judgment that the monetary targets, set much earlier, had been pitched too fine and that their single-minded pursuit was damaging the adjustment process through its effect on investment, exports, and support for the program. Nevertheless, they have persisted in their efforts to meet the staff's targets but, as the report notes, have missed the base money target marginally in some recent months.

All of the quantitative performance criteria for end-March 1992 were met. For end-June, six of the seven performance criteria were met, the shortcoming being in relation to the base money target. Completion of the second--and third--review has thus been delayed, notwithstanding the overall satisfactory performance. With a view to minimizing such problems in the future, technical assistance has been sought from the Monetary and Exchange Affairs Department to better reconcile monetary operating procedures and program design.

The current stand-by arrangement did not have fully assured financing at the outset and was approved under the policy on financing assurances. The key element of the authorities' financing intentions, which the Board supported, was a commercial bank debt arrangement requiring multilateral support. The authorities have pursued that course and an agreement has now been reached with the banks covering debt of $4.6 billion. It is the authorities' intention to close this deal shortly after this review. Doing so will require support from the Fund and the World Bank. As indicated at earlier reviews, the Philippine authorities will be seeking augmented resources from the Fund. It is my firm belief that the track record of policy implementation noted above justifies Board support of the moderate amount of augmentation that would be necessary to signify Fund support and, hence, catalyze other sources of financing. My Philippine authorities would appreciate an indication of Directors' support in principle so that they can proceed with confidence to close the debt deal with the commercial banks.

The Philippine authorities have accepted the staff's requirement that the current stand-by arrangement be extended by three months to end-March 1993. In the meantime, they will be developing proposals to give effect to their desire to move to a growth-oriented phase.

The Government has moved rapidly to establish a cooperative working relationship with Congress to pave the way for the early passage of key pieces of legislation deemed essential to the economic reform agenda. These include several new revenue-raising and tax reform measures; various measures that would further broaden and give substance to foreign investment liberalization, including the entry of foreign competition in the banking industry; a framework for the deregulation of key industries, notably transportation and energy; and a bill that would financially rehabilitate and strengthen the independence of the Central Bank.

My Philippine authorities wish to emphasize that the peaceful transition to a new Administration, which immediately took action on the economic front, has been well received by--and has improved the level of confidence among--foreign and domestic investors. The demonstration by the Administration's new economic team of its firm commitment to the objectives of the economic stabilization program augurs well for greater consistency in policy implementation. With the impending closing of the commercial debt deal before the end of October 1992, all the major elements that have generated uncertainties in the past will have been eliminated. It can be truly said that the Philippine economy is now poised for stable and sustainable growth.

With Fund support, the Philippines has every prospect of achieving external viability within the next few years.

Extending his remarks, Mr. Evans said that the current review under the stand-by arrangement for the Philippines raised an interesting procedural issue that should be considered more carefully during the biennial review of surveillance. The staff report made it clear, and he had emphasized in his statement, that one of the key issues in the current review was the conduct of monetary policy in meeting the targets for the monetary aggregates. Indeed, difficulties in meeting those targets had delayed the completion of the current review. Closely related to those difficulties was the issue of establishing a sound track record of performance, which was a key factor for countries with Fund-supported programs, because such programs served to catalyze actions by other international institutions, such as the World Bank, other development banks, and bilateral donors. In the case of the Philippines, the establishment of a sound track record was central to the successful conclusion of debt negotiations with the commercial banks.

In his view, the essential question was how to judge whether a program was on track, Mr. Evans remarked. In a formal sense, performance under a program was measured against quantified performance criteria, such as those for the monetary aggregates, which by their nature lent themselves to quantification. In the Philippines, for example, the performance criteria were heavily concentrated on reserve money and base money data; as a result, the program had been more or less continually off track in a formal sense, notwithstanding the fact that monetary policy had been extremely tight throughout the program and that the overall performance of the economy had been exceptionally good in terms of meeting or surpassing program objectives. In the end, of course, it was for the Board to decide whether or not a program was on track; but the procedural issue related to the timing of Board consideration of performance under a Fund-supported program required further consideration in the context of the forthcoming general review of surveillance.

Mr. Tabata made the following statement:

At the outset, I would like to express my appreciation to the authorities for the smooth transition to a new Government under the newly elected President. It is also commendable that the authorities implemented a debt buy-back agreement in May 1992 and reached fundamental agreement in July on their debt-reduction negotiations.

In general, the economic situation seems better than expected. Real GNP, which showed no growth in 1991, is projected to increase by 2-3 percent this year owing to the pickup in private fixed investment and consumption. On the fiscal front, the revenue shortfall caused by a delay in the sales of government assets was offset by an increase in customs revenue through the improvement of administration. At the same time, expenditures were reduced mainly through cuts in development outlays and the introduction of a monthly monitoring system. Consequently, the budget deficit fell from 3.4 percent of GNP in 1990 to 2.1 percent of GNP in 1991 and is projected to decrease further to 0.8 percent in 1992. Furthermore, it is also welcome that the rate of inflation has decelerated, although it is still about 10 percent.

The delay in implementing the structural reforms is regrettable; however, there has been substantial progress in the reform of tax administration and the elimination of restrictions on current transactions, and a new foreign investment law was introduced.

On the external front, it is commendable that the current account deficit has narrowed, owing mainly to an upsurge in exports of manufacturing goods and an increase in service receipts. In this context, it is welcome that the issuance of $100 million in bonds in international markets is planned for early 1993.

Despite these favorable results, a number of problems remain unsettled. A large increase in the money supply and the weakening of the monetary policy stance are cause for concern. The authorities have implemented a tight monetary policy during the past couple of months, and base money seems to be under control. However, short-term capital inflows have not necessarily been sterilized, interest rates are declining, and the inflation rate is still high. Under these circumstances, the authorities intend to continue or to ease the current monetary stance somewhat in order to avoid adverse effects on economic recovery and to prevent a further appreciation of the peso. While it is necessary to pursue growth-oriented policies, at the same time, careful and prudent implementation of monetary policy is imperative so as not to rekindle inflation.

As for the fiscal front, although the fiscal deficit has decreased, the fiscal position is still vulnerable. Accordingly, it is imperative to further improve tax administration, reform the value-added tax (VAT), and raise public service charges. At the same time, it is important to continue the exercise of monthly monitoring of budgetary expenditures and to strengthen the financial position of public corporations. In this context, as the staff has pointed out, it is urgent to take measures to improve the financial position of the National Power Corporation.

On the external front, I would like to ask the staff or Mr. Evans about the impact on the current account of the planned high economic growth of 5-6 percent in 1993. The authorities are concerned about the adverse effect of the appreciation of the peso on export industries. As for primary commodities, the profit squeeze caused by the appreciation of the peso will be difficult to absorb through an increase in productivity. However, for the manufacturing industries, the appreciation of the currency will have a favorable effect on the input-output structure, because of a decline in input costs, and should eventually improve external competitiveness. As electronics and other manufacturing goods account for more than 50 percent of total exports, I hope that the authorities will make further efforts to transform the industrial structure so that the favorable effects of the appreciation of the currency can be realized. Regarding the aid receiving system, the administrative procedures for aid acceptance need to be made more efficient. In any event, it is imperative to implement cautious fiscal and monetary policies to strengthen economic stability and the foundation for the new Administration.

Finally, I would like to make a few comments on the proposed decision. On the proposed waiver of the applicability of performance criteria, in the absence of end-September data, this chair is hesitant to approve a waiver. However, as the staff representative from the Southeast Asia and Pacific Department explained, it appears that the performance criteria were observed, and, given the likelihood of a successful debt deal with commercial banks, we are prepared to make an exception in this case. In the future, however, we should by all means avoid such an exceptional case.

Regarding the possible augmentation of the current stand-by arrangement, the long delay in completing the program review is regrettable. However, taking into account the fact that the main part of the financial package agreed with the Philippines' Bank Advisory Committee in February 1992 was an interest reduction bond and that the track record in the last couple of months was better than expected, this chair believes that it is better to consider the possible augmentation of the current stand-by arrangement at today's discussion.

With these comments, I support the proposed decisions.

Mr. Quattrociocche made the following statement:

We broadly share the views expressed by the staff in its excellent paper, and I am glad to convey to the Philippine authorities this chair's appreciation for their policy performance thus far. The new Administration that took office in June 1992 is showing a receptive attitude toward the advice of the Fund. Its commitment to implementing swiftly the reforms indicated by the staff as essential is a very promising start indeed.

We are pleased to see that major steps are being undertaken to restore fiscal discipline and mobilize public resources through tax reform and expenditure controls. Fiscal policy is the key area for reform, and we hope that the new Administration will soon be able to get congressional approval for those measures not acted upon before the expiration of the last Congress.

It is quite evident that contingent factors, such as the registered surplus in the Oil Price Stabilization Fund (OPSF), have contributed to keeping the fiscal deficit within manageable proportions. Revenue mobilization is crucial if long-lasting results are to be achieved in consolidating the fiscal position. Furthermore, we fully endorse the recommendation of the staff not to relax the constraint on budgetary spending, although some selective rearrangement is needed in order to avoid excessive public investment restraint.

The lifting of the levy on non-oil imports is a welcome step, inasmuch as it removes an element of distortion from the market, but it raises some concern because, apparently, no measures have been taken to compensate for the consequent revenue loss. Should that be the case, the highest priority should then be given to the enactment of such measures so as to avoid losing the momentum of adjustment. Furthermore, action should be taken to improve the situation of public corporations. Although the deficit of public corporations is in line with the program projections, the staff points out that this is by and large the outcome of delays and cutbacks in investment outlays. This is no substitute for a comprehensive restructuring of the parastatal sector to ensure viability of public enterprises through restored competitiveness, and we would recommend that consideration be given to such a course of action.

Turning to monetary policy, although the base money target has been missed only marginally in some recent months, as Mr. Evans underlines in his helpful statement, future developments are rather hard to predict. According to the latest available information, excessive monetary growth has brought about a re-kindling of inflation to levels higher than those registered at the end of 1991. Moreover, the lack of a comprehensive financial reform and, most of all, the uncomfortable situation of the Central Bank seriously undermine the possibilities of effecting monetary control. Therefore, notwithstanding the authorities' awareness of the need to promptly reassert monetary control--and we welcome the timely and firm measures undertaken to this end--we would urge them to expedite the process of eliminating the losses incurred by the Central Bank in recent years, so as to strengthen its position and create the conditions for it to run an independent monetary policy.

The external position strengthened during 1991 and the first half of 1992, with considerable improvement in the balance of payments position. Although we consider the projections of the staff somewhat optimistic--especially regarding export growth--we are also convinced that a firm commitment on the part of the Government to further financial restraint and a bold program of structural reforms will pave the way for medium-term viability.

This chair appreciates the determination shown by the Philippine authorities in addressing the serious problems facing their economy. Provided that the record in implementing the current stand-by arrangement continues to be good, this chair is ready to offer its support for the requested moderate augmentation so as to facilitate the conclusion of the debt deal with the commercial banks. In this connection, we would express our satisfaction with the authorities' commitment not to close the debt deal until clear language is included that would avoid linking mandatory prepayments to banks with early repurchases to the Fund. We understand the authorities' concern about the possible repercussions for the Philippines of the outcome of negotiations under way between commercial banks and other debtors, but we think that the need to insert such clarifying language cannot be overstated. Indeed, this is in the best interests of both the country and the Fund, as any alternative solution would only add an unsustainable burden on the Philippines' external position, thus nullifying the improvement in its balance of payments position as well as running counter to the monetary role of the Fund and the revolving character of its resources.

With these observations, on behalf of this chair, I support the proposed decisions.

Mr. Ismael made the following statement:

I commend the authorities of the Philippines for the satisfactory performance of their economic stabilization and structural adjustment program. Inflation has been reduced substantially; the government budgetary deficit has been narrowed, the balance of payments has undergone substantial improvement, and international reserves have increased significantly. I am also pleased to note the new Government's determination to pursue further the current tight monetary and fiscal policies, which are to be augmented by radical policy changes geared toward increasing domestic savings, growth-oriented adjustments, major structural reforms, and a reduction in structural imbalances. These contemplated changes would certainly strengthen the basis for a successful adjustment. Let me now elaborate briefly on the important aspects of the program.

Last year's economic performance of the Philippines attests to its resilience and dynamism to respond to positive policy incentives. With close adherence to the program, I am confident that the remaining economic and structural impediments can gradually be eliminated and the economy revitalized. The second half of 1992 has already shown further signs of recovery. In order to achieve the intended level of growth of 2-3 percent, efforts to reduce inflation should, therefore, be continued to achieve a comparable level with competitor countries, and to increase positive real interest rates as a stronger inducement to savings. In view of the tight budgetary stance and monetary policy, the private sector should take the lead in reviving the economy, especially now that confidence of the private sector in the Government's stabilization program seems to be at a high level and the favorable balance of payments and stronger international reserve positions have provided a conducive environment for more rigorous investment.

At the same time, the practice of tight control over monthly cash expenditures should be continued, as this has been successful in keeping the program on track during the past year. To bring about fiscal adjustment, I agree with the authorities' move to place greater reliance on revenue increases. In this regard, I welcome the authorities' intention to strengthen tax administration, reform the VAT, introduce new legislation to raise excise taxes, and increase user fees and charges. Moreover, crucial to attaining the fiscal objectives of the program is an improvement in the operations of the public enterprises; difficult as it may be, their operations need to be closely scrutinized by the authorities, and immediate actions should be taken to correct any deviations. The continued weak position of the National Power Corporation is a cause for concern, as it will have an adverse effect on other sectors of the economy. Therefore, I urge the authorities to expedite the proposed review of energy pricing policies, covering the deregulation of oil prices and increases in electricity tariffs.

On the monetary front, I note with interest that the authorities' successful measures to keep monetary growth and the exchange rate in balance were easily destabilized by political events. Despite the easing of foreign exchange inflows, which, in my view, was also influenced by the elections, the resurgence of inflation is a cause for concern. In this regard, I welcome the authorities' decision to increase interest rates and the volume of treasury bills in the hope that these steps would bring down base money to the program level again. With these observations, I support the proposed decisions.

Mr. Dawson made the following statement:

We are pleased that after a delay of several months, the Philippines is now in a position to conclude the second and third program reviews for its stand-by arrangement. As Mr. Evans reminds us in his "graphic" statement, the first 19 months of this somewhat elongated stand-by arrangement have seen some notable stabilization accomplishments. Despite weak growth, targets for fiscal deficits, reserves, and external borrowing have been met. The authorities demonstrated considerable political fortitude when, in the run-up to the elections, they cut spending to keep it in line with disappointing revenue flows. Monetary performance has been more fitful, with the authorities repeatedly scrambling to claw back overruns. We believe the staff deserves credit for working closely with the Philippines during difficult passages, insisting on performance but sustaining cooperation. All in all, the discipline of the program has allowed the Philippines to moderate inflation and establish a more secure external position despite an unsettled period of electoral transition.

With installation of the new Ramos Administration, much of the political uncertainty has been removed. We are pleased the new Government has publicly committed itself to the present program and that its actions have been consistent with that commitment.

At the aggregate level, the Philippines has benefited from the discipline required by the stand-by arrangement. Viewed from a slightly disaggregated perspective, however, it is clear that policy implementation has been patchy and structural distortions in the public sector have gone uncorrected.

In the monetary area, the authorities have tended to treat program limits as targets, not ceilings. In our view, the overshooting of monetary targets for May, June, and July 1992 resulted mainly from a reluctance to tolerate higher interest rates when they were needed to limit the growth of bank liquidity.

Belatedly, compensatory measures have been taken, but ground has been given up in the battle against inflation. Inflation has again risen into the low double digits. The objective of the stand-by arrangement of a 7 percent rate of inflation by the end of 1992 now looks beyond reach.

Orderly fiscal policy is undermined by structural distortions on the revenue side of the ledger. The long wrangles over the temporary import levy and the Oil Price Stabilization Fund reflect the continuing need for more reliable and broader-based revenue sources. Better collection of taxes that are now on the books would solve part of the revenue problem. Some improvements are being made, but thoroughgoing administrative reforms have yet to be adopted.

In the absence of adequate funding, the expenditure side of the ledger has been cannibalized. Investment and development outlays have borne the brunt of spending control. In the process, priorities have been distorted. Foreign assistance projects have been disrupted because of cuts in counterpart funds lending. Cutbacks have posed particular problems for assistance from the Asian Development Bank, the World Bank, and Japan and only compounded long-standing pipeline problems in the Philippines.

Structural problems in the public enterprise sector persist, and these entities continue to place a drain on general account resources. The dismaying episode of the electricity price rollback immediately following the previous performance review vividly illustrates the need for a more resolute approach to correcting basic structural problems.

Despite the discipline the Philippines has shown in staying within overall borrowing limits, far more coherence is needed in public sector funding and public sector spending if long-run development goals are to be met.

The need for a more coherent approach to structural reform is indicated by two issues now before the World Bank. A $134 million loan for a telephone system expansion is proposed for a Philippine company that is listed on the American stock exchange. With the Philippines now beginning to re-establish its access to international credit markets, this strikes us as a particularly flagrant and unnecessary example of the tendency to distort priorities and incentives. This is a good opportunity for the Philippines to test itself in international credit markets rather than soak up easy credits for undemanding uses. As for the World Bank's involvement, it ought to know better.

At the other extreme, where reform is needed to qualify for World Bank credits, reform has not been forthcoming. A second and final $150 million tranche of a World Bank Financial Sector Adjustment Loan is nearly two years behind schedule because the necessary legislation to amend the Central Bank Act has languished in the Congress. Wider reforms are needed to enhance market efficiency and lower intermediation costs.

We support today's decision with respect to the completion of this review, including the necessary waivers. We believe that the staff's proposal to extend the period of the stand-by arrangement through March 1993, so that there is an opportunity to test performance through the end of December 1992 before the final tranche of the stand-by arrangement is released, is entirely appropriate. Likewise, we support the provision in the proposed decision with respect to the release of set-asides to support the commercial bank debt restructuring. We are also gratified to hear and we strongly support the Philippine authorities' expressed intention to make sure that the final augmentation of the bank deal includes the clarifying language necessary to distinguish voluntary repurchases pursuant to obligations or expectations.

The Philippine authorities now indicate that they hope for a modest augmentation of the stand-by arrangement to support the debt restructuring. We have been somewhat surprised by the on-again, off-again nature of Philippine intentions regarding augmentation. We had had the impression that the request for augmentation had been dropped because the Philippine authorities believed they now had adequate resources of their own to provide the necessary enhancements. On surface appearances, this appears to be the case, and we would appreciate further explanation from the staff about the role augmentation would play in concluding the bank deal.

In February 1992, we indicated that we would be prepared to support a request for augmentation if the Philippines' performance continued to be satisfactory under the stand-by arrangement. That continues to be our view. We believe it is important for the Philippines to capitalize on the progress it has made to get the bank debt problem behind it. The rephased dates for concluding the stand-by arrangement provide an opportunity to review five more months of performance of the new Philippine Government under this program. Assuming that performance is satisfactory, we remain willing to consider a modest augmentation of the stand-by.

The staff report alludes to the desirability of a follow-on medium-term program that would include elements of structural reform. Such a program could help consolidate the gains made under the present stand-by arrangement and address the remaining structural reforms that will underpin sustainable growth and development. However, continued support for the Philippines, and other members with which the Fund has had long-term relationships, must be weighed against increasing demands on Fund resources from new borrowers. Despite prolonged use, the Philippines record in overcoming balance of payments difficulties and in completing programs has been spotty.

To warrant our support, we believe a successor medium-term program should be comprehensive in scope, addressing many of the structural problems we identified above, but smaller in terms of the financial support provided by the Fund than, for instance, the previous medium-term program with the Philippines. The staff indicates that the balance of payments outlook for the Philippines is good and would be further improved by the expected completion of the commercial bank deal. This situation would seem to provide sufficient stability to graduate the Philippines from Fund supervision over the next several years.

Close Fund involvement has undoubtedly improved policy management. The medium-term objective, however, should be self-reliant, sound economic management. Thailand, Malaysia, Korea, and Singapore provide nearby examples of highly successful broad-based reforms without continued Fund involvement. Nor should Fund resources be the primary incentive for reform; the prospect that the Philippines might be able to achieve the rapid economic growth and increased competitiveness enjoyed by other countries in the region that have undertaken serious reforms should be adequate enough incentive for further structural reforms.

It may take some ingenuity, but we look forward to a relationship of growing maturity between the Fund and the Philippines in the years ahead.

Mr. Végh made the following statement:

The Philippine economy is undergoing an intense process of transformation. The smooth transition of power within the democratic institutions that took place this year and the commitment of the new authorities to the adjustment process constitute most welcome developments, which strengthen the chances that the Philippines will attain high levels of growth and external viability, becoming in the not so distant future another example of successful adjustment.

Fiscal consolidation demands renewed efforts on the revenue side of the budget. The detailed program the authorities are trying to implement to improve fiscal administration should be given high priority, as it constitutes the backbone of the adjustment process. The resort to expenditure cuts that affect infrastructure works and social programs, all too often involving the basic needs of the population, reveals the determination of the authorities to take unpleasant decisions. This can only be a short-run solution, however. Among the tax measures that have already been implemented, the increased penalties for tax evasion and the establishment of special tax courts seem to us of particular importance. In order for this new law to be effective, however, it is very important that the creation of a large taxpayers' unit is not further delayed by the Congress.

I welcome the authorities' Energy Sector Action Plan, which envisages deregulation of oil prices, but, at the same time, I wonder why the National Power Corporation has not been considered for privatization, as this would be a cost-efficient way of reducing the fiscal burden often associated with its operations. Moreover, apart from the favorable fiscal effect, privatization would probably encourage better investment decisions, because the existing power shortages suggest bad planning, probably associated with either excess capacity or the mistaken idea of "normal rainfall," to which I have referred in other Board discussions.

In the context of measures to alleviate rural poverty, the staff alludes to the Comprehensive Agrarian Reform Program. As the experience of some Latin American countries in agrarian reform has been a rather unhappy one, I would appreciate some explanation from the staff regarding the nature and scope of the Philippine program. In the case of Peru, one of the countries in my constituency, the agrarian reform conducted in the 1970s by the military dictatorship then in government, which imposed enforced collectivization of land property, resulted in an unmitigated disaster, with consequences that are still burdening the economic, social, and political outlook of the country. I sincerely hope that the Philippine authorities are not embarking on a similar enterprise.

Turning to the monetary area, the Philippine authorities, notwithstanding some temporary excesses during the electoral period, have proved their willingness to abide by the limits under the program for reducing the monetary aggregates in a difficult financial context owing to the large inflow of foreign capital and the need to sterilize those flows. The staff report points out that in spite of the sterilization, interest rates were on a declining trend, and the report attributes this to, among other factors, improved confidence with the implementation of the stabilization program. It appears, therefore, that there are some reinforcing mechanisms working in the right direction. Notwithstanding these considerations, a disturbing fact comes out of the Tables in the staff report, namely, the extremely high real rate of interest that was in effect during the first half of 1992 in spite of the fact that the inflation rate was higher than projected. Taking the average lending rate in that period--about 20 percent--and comparing it with the consumer price index inflation rate of 9.2 percent, we obtain a real interest rate of more than 10 percent. This value does not bode well for the need to stimulate productive investment in order to achieve the ambitious targets of export growth envisaged in the medium-term scenario. Moreover, high real interest rates constitute a perverse incentive to attract even larger amounts of interest-driven capital inflows.

In this context, let me make some additional remarks on the very important and fashionable subject of the conflict facing monetary and exchange rate policy between the objectives of reducing inflation and maintaining the external competitiveness of the economy. During a few recent Board meetings, I called attention to a recent paper concerning this matter and, especially, the likelihood of success of sterilization techniques in providing some solution to this conflict. 1/ As some Directors may recall, the conclusions of that paper were rather pessimistic regarding the chances for a successful resolution of that conflict. In the same context, let me draw the attention of the Board to another paper that was distributed this week on external shocks and inflation in developing countries under a real exchange rate rule. 2/ The concluding section (pages 28-29) of that paper reads as follows:

> This paper has attempted to analyze some of the important macroeconomic issues surrounding real exchange rate targeting in developing countries. The first part of the paper sought to answer two main questions in the context of a reference model that assumed perfect capital mobility. First, how does the level at which the authorities choose to target the real exchange rate affect the economy's steady-state rate of inflation? Here, it was found that the more depreciated the real exchange rate target relative to the equilibrium rate, the higher will be the level of inflation. Second, what is the effect of real disturbances, taken for our purposes to be terms of trade shocks, on the inflation rate? It was found that whereas real shocks would have no effect on the steady-state inflation rate under a fixed nominal exchange rate or crawling-peg regime, this

---

1/ Calvo, G., L. Leiderman, and C. Reinhart, "Capital Inflows and Real Exchange Rate Appreciation in Latin America: The Role of External Factors," WP/92/62, August 1992.

2/ Montiel, P. and J. Ostry, "External Shocks and Inflation in Developing Countries Under a Real Exchange Rate Rule," WP/92/75, September 1992.

was no longer the case under real exchange rate targeting. For example, it was shown that an improvement in the terms of trade would raise the economy's steady-state inflation level under real exchange rate targeting and that the attempt to mitigate this outcome by altering domestic credit policy would prove to be fruitless.

Given the results in the first part of the paper and in particular the fact that, under perfect capital mobility, domestic credit policy could not substitute for the traditional role of the exchange rate as the nominal anchor for the domestic price level, the second part of the paper considered the case in which capital controls were imposed, thereby rendering sterilization feasible, and asked whether money-supply targeting could stabilize the price level in response to shocks when the authorities targeted the real exchange rate. It was argued that when capital controls are perfect, so that the government can permanently segment official and unofficial markets for foreign exchange, the inflation rate can indeed be stabilized in the face of exogenous shocks when the authorities follow an appropriately chosen money-supply rule. However, we also showed that the stabilization of the inflation rate carried with it the implication that in the long-run equilibrium, an ever-widening gap between the official and unofficial exchange rates would emerge. Since this growing gap between the two exchange rates would ultimately create unbounded incentives to engage in cross-transactions between official and unofficial markets, we argued that the effectiveness of capital controls could not ultimately be sustained.

The paper went on to examine whether monetary targeting could effectively stabilize the inflation rate when these incentives for cross-transactions create leakages between official and unofficial markets for foreign exchange. Our finding once again was that using money as a nominal anchor for the price level is problematic. Although the model with cross-transactions did not possess the difficulty that the gap between official and unofficial exchange rates grew continuously in the steady state, and hence avoided some of the problems that were inherent in the model with perfect capital controls, our conclusion was nonetheless that a money-supply rule could not prevent the emergence of inflation when the economy was subjected to a permanent terms of trade shock. The reason was simply that, in the presence of leakages, the long-run behavior of the economy

> must be identical to that of an economy without any capital controls, i.e., with perfect capital mobility. Since, under perfect capital mobility, changes in the stock of credit cannot affect the real money supply, so too in the model with leakages, the money supply becomes endogenous and hence cannot be used as a nominal anchor for the domestic price level. In addition, however, the paper showed that if capital controls are used temporarily to target the rate of growth of the money supply, a monetary rule would still fail to stabilize the rate of inflation even in the short run.
>
> To conclude, then, this study finds little support for the view that a money-supply rule can stabilize the inflation rate when the authorities target the real exchange rate. When, as under real exchange rate targeting, the nominal exchange rate cannot serve as an anchor for the domestic price level, we find that the money supply cannot serve as an alternative nominal anchor.

If these and other research papers are correct in their evaluations--and there is little reason to believe that it could be otherwise, not only because of the academic levels of their authors, but also because their theoretical conclusions support what is the intuitive knowledge from experience of policymakers in this field--a choice has to be made between the conflicting objectives. With this in mind, I strongly support the policy recommendation and the advice given by the Fund staff in the last paragraph on page 24 of the staff report, which reads:

> In the staff's view, returning base money to the program path in the remainder of 1992 will be critical to achieving the program's objective of reducing inflation in a sustained manner. In the present environment, maintaining the necessary degree of monetary tightness may involve upward pressure on the value of the peso in the exchange market, from levels which already--were they to be sustained for long enough--would cause difficulties for exporters. However, the staff believes that such pressures are unlikely to endure and that, in any case, the most lasting contribution that policies can make to encouraging exports is in restoring and sustaining reasonable price stability.

Although there are signs that the level of economic activity is improving, the 0.5 percent growth recorded during the first half of 1992 over the same period in 1991 is substantially below potential. The pickup in investment in durable equipment to 11 percent during the first half of 1992 is, however, an encouraging sign pointing to the importance of a favorable political climate and the positive effects of a more liberal foreign investment regime to stimulate investment decisions. In any event, the sharp contraction of growth in 1991 and its still low level in 1992 should be closely monitored, as a stagnant economy may strengthen the political forces opposed to the process of liberalization and privatization of the economy.

The external accounts present a better outlook than in the past. Increased workers' remittances and capital inflows will more than compensate for the projected deficit in the trade balance. The almost complete liberalization of the foreign exchange market, including the elimination of surrender requirements on export proceeds, will certainly contribute to achieving external viability by strengthening the services and capital accounts. Nevertheless, continued trade balance deficits call for further measures to increase the efficiency and competitiveness of the export sector, so as to achieve the high rates of export growth projected in the medium-term scenario. The need for such measures is even more apparent in view of the scope for additional trade liberalization. The higher rates of domestic growth and a stronger peso will put continued pressure on the import side of the trade balance.

The reduced current account deficit projected by the end of the decade hinges on export growth rates of 14 percent a year for most of the decade, which demands a superb performance from the Philippine economy. Furthermore, given that, according to the staff report, partner countries' import volume growth is assumed to be 8 percent in the medium-term projections, one should conclude that the remaining growth of exports will come out of a larger market share for the Philippines' exports. I would appreciate staff comments on this point. On the topic of encouraging exports, I fully agree with the staff appraisal that the most lasting contribution that policies can make in this regard is sustaining reasonable price stability. I am concerned, therefore, that average labor costs increased at a faster rate than productivity during 1991, particularly in the manufacturing sector.

The agreement reached with the Philippines' commercial bank creditors on a debt-service reduction package, and the recent implementation of its buy-back option covering debt with a face value of $1.3 billion through an initial use of $656 million in own reserves, represent most welcome developments. The Fund's endorsement of the agreement through expeditious release of the set-aside amounts accumulated is fully justified. A moderate amount of augmentation resources also appears necessary, and the Fund should not hesitate in providing these resources as soon as possible so that the momentum created by the efforts of adjustment and structural transformation can be consolidated through a rapid closing of the agreement with the commercial banks. Such an action will not only help to dispel uncertainties on the external financing of the program but also reduce the country risk premium affecting domestic investment, as well as the risk of Fund exposure in the Philippines.

With respect to the need to include proper language in the agreement concerning the distinction between voluntary prepayments and Fund repurchases pursuant to expectations or obligations, it should be kept in mind that the negotiating capacity of debtor countries has its limitations when it comes to setting precedents. Therefore, a more active involvement of both the Fund and creditor country governments in support of a performing debtor's initiative is called for in order to arrive expeditiously at the desired results; the financial integrity of the Fund is the business of the entire membership.

Finally, I support the proposed decision on the stand-by arrangement, and I hope that the Philippines can move to Article VIII status in the near future. On the proposed decision on the 1992 consultation, however, I have some difficulty with the precedent that is being set in paragraph 2 regarding the indicative deadline for completion of Paris Club bilateral agreements. The relevant provision of the proposed decision sidetracks attention from a policy issue to an operational issue, which is currently being dealt with by the debtor, the Paris Club secretariat, and official creditors. I would appreciate clarification as to why a justifiable overrun would be construed as an intensification of restrictions when such debts have specifically been subject to an understanding between the parties concerned.

Mr. Al-Jasser made the following statement:

I would like to begin by welcoming the incoming Philippine Administration's renewed commitment to the goals of sound economic growth and stabilization. I also share many of the sensibly balanced views expressed in Mr. Evans's helpful statement concerning recent developments and the authorities' intentions for the future.

Looking back over the past year, it is encouraging to observe that, despite the difficult political circumstances, the authorities have achieved further success in reducing financial imbalances. In particular, the authorities are to be commended for adhering to the program's budget deficit target in the face of unanticipated revenue shortfalls. Moreover, further significant reforms in the exchange, trade, and investment regimes were enacted.

Notwithstanding the progress made toward restoring financial stability and, in some respects, overperformance relative to program objectives, the foundation of this improvement needs to be solidified. In this regard, the authorities' new public mandate, as well as continuing favorable external circumstances, provide them with an opportune moment to press ahead with critical structural reforms, notably in the budget and the public sector. Action in these areas would enhance considerably prospects for growth and external viability. I am in broad agreement with the staff's appraisal and, therefore, will be selective in my remarks.

The process of fiscal consolidation is key to the authorities' stabilization efforts, and, thus far, good progress has been achieved. However, this success should not be allowed to mask the need for tax reform to ensure that the consolidation effort is sustained. In this regard, it is regrettable that part of the revenue shortfall recorded this year was due to slippages in implementing tax administration and other revenue-raising measures. Nevertheless, the program's budget deficit targets were met, thanks to timely reductions in expenditures. However, reactive cutbacks in spending to below budgeted levels are typically only effective over the short run, and can be potentially damaging to public resource management over the longer run. Indeed, it is unfortunate that much-needed development capital expenditures bore the brunt of these spending cuts. Thus, I welcome the priority given by the authorities to enacting their legislative program for tax reforms designed to enhance the revenue effort, as well as to improve efficiency.

As a side point, I would like to explore an issue that Mr. Dawson emphasized, namely, the need to preserve counterpart funds in the budget, especially for development projects. The other day, I heard that the World Bank was studying the disbursement of Bank funds that remain in the pipeline, especially in some of the Asian countries. One of the reasons for the slow pace of disbursements is that when the budgetary situation becomes very tight, the first items to be cut out of the budget are development projects, namely, the budgetary counterpart of external financing. Therefore, the funds coming from the World Bank--and, I presume, other development institutions--are delayed or stopped. Hence, I hope that, in cases where this is a serious problem, the staff will pay more attention to this issue in its analysis; at least the staff should bring to our attention the impact of budgetary tightening on the development of the economy, especially as regards development spending, because such outlays enhance the potential of the economy in the future.

The sizable reduction in the public sector borrowing requirement since 1990 reflects not only the authorities' fiscal discipline, but also the decline in world oil prices and interest rates. These latter two factors helped generate large surpluses in the Oil Price Stabilization Fund and reduced the losses of the Central Bank, but they should not be relied upon as a continuing source of fiscal relief. Indeed, in 1992, the better than projected financial outturn for these two entities exceeds the overall improvement in the consolidated public sector deficit. Clearly, this highlights the need for further reforms in those areas of the public sector where shortfalls in performance have occurred.

That being said, the Central Bank remains a source of sizable losses, which are projected to amount to over half of the consolidated public sector deficit in 1992. Therefore, I welcome the authorities' intention to rehabilitate the Central Bank's operations and balance sheet, and I urge them to do so as rapidly as possible. Among other things, the elimination of central bank losses would allow the Bank to rely less on high reserve requirements in its monetary control operations, which impede financial intermediation.

Another important financial drain on the public sector is the large losses incurred by the National Power Corporation, which reflects, inter alia, a weak power supply and distribution network. More significantly, the weak position and performance of the Corporation is likely to have a negative impact on private sector growth. In this context, it is highly regrettable that cutbacks in investment had to be implemented in the face of rising costs and inadequate revenues. Therefore, I encourage the authorities to expedite the preparation of the Energy Sector Action Plan. A key element of such a plan will be the reform of energy pricing policies; however, attention should also be paid to containing costs and improving productivity. In addition, I trust that the proposed Plan will review domestic oil pricing policy, which currently is generating large surpluses in the Oil Price Stabilization Fund rather than improving the cost environment for private sector production, including energy production.

The authorities are to be commended for the comprehensive liberalization of the current and capital accounts, and I encourage them to accept the obligations of Article VIII of the Fund. These measures, together with the development of the exchange market and liberalization of the trade and investment regimes, will contribute significantly to both investment and export prospects, which are vital to future external viability. The near conclusion of the commercial bank debt operation is also a welcome development, and will play an important role in bringing the

Philippines closer to a sustainable balance of payments position. In this context, I can support, in principle, a moderate augmentation of resources from the Fund, with consideration of this issue to be undertaken in connection with the final purchase under the arrangement.

More specifically on the commercial bank debt agreement, I strongly support the need for the final documentation to include language distinguishing voluntary prepayments from Fund repurchases pursuant to expectations or obligations. Moreover, I believe it would be helpful to both the authorities and the Fund if this sentiment was communicated to the banks, perhaps in the form of a letter from the Managing Director. I would appreciate the Acting Chairman's or the staff's views on this point.

I support the decisions before us today. The Fund's continued collaboration with the Philippines is a vital ingredient in sustaining the authorities' reform efforts. These efforts have already borne considerable fruit, as witnessed by the Government's ability to now consider re-entering international financial markets. Nevertheless, as the authorities recognize in their desire to embark on a successor arrangement with the Fund, much reform work remains to be done. In this regard, it would be helpful if a successor program incorporated at an early stage concrete plans for critical structural reforms, notably in the energy sector and the Central Bank.

Mrs. Martel made the following statement:

The progress achieved so far under the Philippines' stabilization program in restoring financial stability has been rather impressive. Crucial to this achievement have been the fiscal consolidation and the strengthening of the external position. Against this positive background, inflationary pressures have rebounded in mid-1992--to double-digit levels at an annualized rate--and economic growth has remained sluggish, reflecting a contraction in investment.

The crux of the adjustment problem in the Philippines lies in some structural weaknesses in the external sector, on the one hand, and in the domestic revenue mobilization system, on the other hand. The external sector is characterized by high import dependence and the relatively slow growth of exports and its narrow-based structure. These aspects have led the Philippines to a history of recurrent balance of payments crises.

The recourse to the domestic revenue mobilization system to try to resolve external payments crises has proved difficult, because the system has structural rigidities of its own and is characterized by low rates of public and private savings. Therefore, I agree with the staff that the short- and medium-term task is twofold: first, to stick to focusing on fiscal adjustment, which will help increase domestic savings and noninflationary growth; and second, to continue relaxing the external constraint through the maintenance of a stable and small current account deficit. I shall deal successively with these two points.

Fiscal adjustment is central to the stabilization objectives. A key target in this regard is the reduction of the consolidated public sector deficit to 2.7 percent of GNP in 1992. I understand that this deficit could be held to less than 2 percent, which would be a remarkable achievement. However, the manner in which this achievement is reached is critical to the adjustment process. The success of the fiscal strategy lies in the enhancement of domestic revenue and in the careful management of public expenditure.

As far as domestic revenue increases are concerned, expanding the tax base and improving tax collection are both required. Indeed, the actual amount of taxes collected has been lower than the amounts targeted in each of the past five years, and the elasticity of tax revenue to national income seems to be abnormally low. Therefore, the measures that the new Administration intends to discuss with the Congress, such as raising excise taxes, reforming the VAT, and increasing user fees and charges, are most welcome. Also important are the steps taken by the authorities to improve tax and customs administration. I note with satisfaction that a new VAT bill has been included in the package of tax measures presented to Congress. I would appreciate some comments from the staff on this package of tax bills.

The necessary measures taken to cut back expenditure should preserve the possibility of future growth. In this regard, the drastic reduction in capital outlays in 1992--which are projected to be peso 32.7 billion, compared with peso 38.5 billion in the revised program, peso 60.5 billion in the original program, and peso 51.3 billion in 1991--cannot be sustainable for long. Priority should be given to careful management of public expenditure, and special attention should be paid to improving the operational and financial performance of public enterprises.

In recent years, the Philippines has attempted both financial and management restructuring of government corporations. Financial restructuring has taken the form of a strong reduction in net budgetary transfers to government corporations and has contributed to greater financial autonomy. Nonetheless, the success of this financial restructuring must be qualified by the fact that there was little attempt to generate internal cash through market-oriented adjustment of user charges, and there was a sharp cutback in the size of the overall capital expenditure program for government corporations. On the whole, the poor financial performance of some of the monitored nonfinancial public corporations suggests that measures such as higher user charges and better cost control should be undertaken immediately. This observation is bolstered by the recent experience of the National Power Corporation.

On monetary policy, I share the staff's view that it is necessary to maintain monetary tightness so as to reduce inflation in a sustained manner. It is true that the rebound in inflation has not been as high as previously projected. I must say that, coming after the slippages in meeting the base money target that delayed the program reviews, I was impressed by the recent measures taken by the authorities and their commitment to take additional measures if needed.

Turning to the external sector, the measures aimed at further reinforcing the external position and relaxing the external constraint are crucial for the success of the adjustment strategy. The measures already put in place have contributed to a strengthening of the balance of payments, with a narrowing of the current account deficit and a boost in the reserves position. The structural measures, such as the liberalization of the exchange system, the reform of the foreign investment regime and the tariff system, and the elimination of quantitative import restrictions, are also critical.

I very much welcome the agreement reached with commercial banks involving debt and debt-service reduction. The agreement gives the Philippines a significant amount of debt relief on its commercial bank debt. However, as eligible commercial debt accounts for only a relatively small share of total external debt--about 16 percent--it does not seem that this operation will lead to very dramatic changes in the aggregate debt ratios of the Philippines. It is likely, however, that the impact of the conclusion of the debt deal on creditworthiness will be significant, because it would reinforce the return of confidence already apparent, and it should bring the Philippines up to investment grade status for commercial lenders. I agree that clarifying language distinguishing voluntary prepayments from Fund repurchases pursuant to expectations or obligations is a necessary element to be included in the final document of the package, and I hope that its inclusion will not delay too much the final agreement.

This chair can agree with the request of the authorities to purchase the accumulated set-aside amounts. I understand, however, that the authorities have expressed their desire to seek an augmentation of the current stand-by arrangement, which could be taken up in connection with the final purchase under the arrangement. I would be interested to learn from the staff what its approach to such a request might be. This issue is especially important, and the Board's decision on additional resources for the Philippines should take into account the establishment of a continuing track record of performance and the efforts of other sources of financing under various options.

Finally, I agree with the proposed decisions. Considering the progress already achieved and the commitment of the authorities to the objectives of the economic stabilization program, the support of this institution is deserved. For the future, it is clear that the new Administration can build on the success already attained by implementing and following up on the current program thoroughly and by putting in place a medium-term framework aimed at creating an environment for higher and sustainable noninflationary growth.

Mr. Noonan made the following statement:

Recent developments in the Philippines have been encouraging, as both the staff report and Mr. Evans's statement make clear. Economic activity appears set to increase appreciably in an environment of moderate inflation, the external position has strengthened, and public sector finances have outperformed our expectations. Moreover, the new Administration's commitment to sustained macroeconomic reform and structural adjustment has also increased market confidence, which has been reflected in strong inflows of workers' remittances and greater foreign investment, and has helped the authorities to rebuild sizable international reserves.

Despite the economic upturn apparently under way in the Philippines and brighter prospects than we have seen for some time, we have a number of concerns and reservations. In particular, despite the measures the authorities have taken to tighten policy since the election, monetary policy still appears too lax. We are concerned that the authorities are perhaps too focused on external considerations. The Central Bank has been intervening, sometimes aggressively, in foreign exchange markets to prevent the peso from appreciating against the U.S. dollar. If inflation is to continue to moderate, monetary growth must be kept well within the program path, even if this means a stronger peso. In our view, monetary policy should be directed toward achieving greater price stability and should not be diverted from that objective to provide short-term help to the export sector.

We are also concerned that fiscal policy could do more to support an environment conducive to desirably higher rates of public and private investment, on which faster growth ultimately depends. For instance, the public sector's continuing borrowing requirement in tight monetary conditions has contributed to a situation in which holding treasury bills has been more remunerative than investing in productive undertakings. While we can commend the authorities for containing the public finances in line with the program path, despite election pressures and weak government revenues, we share the staff's, and many other Directors', concern about the continued reduction in expenditure on building and maintaining infrastructure. We do not accept that this was the only option open to the authorities to keep the public finances in line with the program, and its adoption will likely have undermined medium-term economic growth prospects. Instead, we would prefer to have seen the authorities place a higher priority on tax measures to strengthen the revenue performance. We would strongly urge the authorities to work with the Congress so as to pass swiftly the needed legislation to improve tax administration and broaden the revenue base, measures that have been stalled for far too long. Reform of the Central Bank, and addressing its losses, should also be a priority of the new Government, as the Central Bank plays a key role in our concerns over the outlook for the fiscal situation.

With respect to the balance of payments, it is encouraging that external viability is expected to be restored by the middle of the decade. In our view, this is a more realistic assessment than the one made at the beginning of the stand-by arrangement last year. Even so, the latest projections still appear too conservative. A successful conclusion to the negotiations on the commercial bank package will advance significantly the date on which viability is achieved. Moreover, a return to voluntary capital markets appears at hand. In any event, it is not clear to us that financing gaps need to be closed through further rescheduling or additional support under the auspices of the Consultative Group for the Philippines. We note that the Philippines is already having some difficulties spending the firm commitments they have received.

This leads us to our final concern, the program changes requested by the authorities. While we support the release of accumulated set-asides in light of the fact that the Philippines has already funded buy-backs out of its own resources, we wonder why the authorities would want the resources at this time, given the relative size of international reserves. With regard to Mr. Evans's request for an indication of Directors' views on a moderate augmentation of Fund resources, this chair has maintained that, in principle, Fund resources to support debt and debt-service reduction should be used flexibly. However, like Mr. Dawson, we believe that further analysis of the Philippines' financing needs by the staff is required before we would want to consider possible augmentation of the current stand-by arrangement.

The rephasing and extension of the stand-by arrangement causes us difficulty, as they undermine the conditionality of the program. So, too, does completion of the review before data with respect to end-September 1992 performance criteria are available. In our view, it is unfortunate that the Board finds itself faced with the dilemma of approving the disbursement of what is in effect the June tranche and one half of the September tranche when the end-June base money performance criterion was not met and, moreover, with a reasonably clear indication that the end-September criterion will not be met. While the staff earlier expressed confidence that the measures taken to tighten policy were sufficient, the aggressive intervention by the Central Bank in foreign exchange markets in recent weeks suggested to us that there was a risk that base money would continue to exceed the performance criterion.

The proposition is advanced that the early review is necessary so that the authorities can move to complete the commercial bank deal. We understand that the completion of that deal is dependent on the approval of acceptable language on mandatory prepayments. In light of this, the case made in Section V of the staff report for the earliest review of the Philippines' progress under the stand-by arrangement and disbursement of Fund resources does not appear to us to have been particularly convincing. However, in light of the general consensus that significant progress has been made by the Philippines, that extension of the arrangement will allow the Philippines a further opportunity to establish a firm track record, and, moreover, that the end-September monetary performance criterion will be missed only marginally, I can support the proposed revised decision on the stand-by arrangement and the proposed decision on the exchange system.

Mr. Esdar made the following statement:

Like other speakers, I would like to commend the new Government for its commitment to adhere to the stabilization program as agreed, which is demonstrated by the corrective measures introduced recently in the monetary area. With regard to the analysis of the economic situation and the policy recommendations, I can endorse the staff's views and findings. Fiscal consolidation, restrained monetary policy, and structural reforms have to remain at the core of the reform process.

In this regard, it is encouraging that despite considerable revenue shortfalls, the fiscal targets of the program have been met. However, like the staff and other speakers, I am concerned that fiscal objectives were achieved only by considerable cuts in investment and development expenditures, thus undermining the medium-term growth prospects. Therefore, I strongly support the staff's recommendations to put more emphasis on broadening the revenue base and increasing the efficiency and implementation capacity of the tax system. In addition, tight control should be exercised over current expenditures, especially subsidies, and it is important to improve the efficiency of public enterprises. In this regard, the weak position of the National Power Corporation remains a concern, and I fully share the staff's view that the highest priority has to be given to adjusting electricity tariffs to market conditions.

On monetary policy, continued and even accelerating inflationary pressures demonstrate the need to pursue a tight monetary policy. An easing of the anti-inflationary stance would not only undermine the basis for sustainable growth and weaken external competitiveness but could also jeopardize balance of payments viability, which remains rather fragile. The recent easing of foreign capital inflows in a climate of resurgent inflation and a continued downward trend of real interest rates illustrates the sensitivity of capital flows.

With regard to the commercial debt operation, like previous speakers, I would like to strongly encourage the authorities to pay due regard to the Fund's preferred creditor status in their negotiations with the banks.

With respect to the timing of this Board discussion, I very much share the concern of Mr. Noonan that, given the considerable delays in the completion of the review and the renewed request to extend the duration of the stand-by arrangement, it would have been more appropriate to present this review to the Board after the data concerning the end-September performance criteria were made available. This would have given the Board the opportunity to get a clearer picture of whether the program is back on track, while not unduly delaying negotiations with the commercial banks. I would be grateful to learn from the staff why it preferred another approach.

Concerning the proposed rephasing and extension of the arrangement, I wonder whether, in view of the delays in completing the reviews and the rather comfortable level of foreign reserves, as well as the Philippines' rather large debtor position vis-à-vis the Fund, a reduction in the originally agreed maximum access has been discussed. Based on a convincing implementation of the program, a voluntary decision not to draw the full amount under the stand-by arrangement could strengthen the credibility of the reform program in the eyes of domestic and foreign private investors and creditors and would facilitate support for the announced augmentation request. In that connection, I strongly endorse the view of Mrs. Martel, Mr. Dawson, and Mr. Noonan that the final decision on augmentation has to be made in light of the ongoing performance under the program. In addition, the staff should provide us with a clear and detailed picture of the financing requirements of the commercial bank agreement.

I have noted in the report that the staff is looking forward to early discussions with the authorities concerning a successor program. Given the considerable financial involvement of the Fund in the Philippines, and given that future emphasis has to be put on structural reforms in particular, I wonder whether the World Bank could play a more prominent role and whether the Fund should limit its involvement to a monitoring agreement. Such an approach would pay due regard to the need to avoid a prolonged use of Fund resources by the Philippines and would reflect the Bank's competence in the structural area.

The staff representative from the Southeast Asia and Pacific Department noted that the comprehensive agricultural reform program was an early initiative of the previous Government, commencing in 1987. Many of the easier parts of the reform program, which was currently about 60 percent complete, had been implemented, focusing particularly on the distribution of publicly owned land. Implementation of the program had run into some problems in recent years, however, owing largely to difficulties in the acquisition and distribution of privately owned land. It was too early to judge the intentions of the new Government in that regard. The staff believed that there was a need to carry reform forward in that area in due course, however, because of the importance of the agriculture sector and the structural impediments to agricultural development imposed by the land tenure arrangement.

On the consequences of the shortage of counterpart funds, he would not disagree with Mr. Dawson's characterization that the authorities had been forced to cannibalize the budget, the staff representative commented. However, the pressure in that area did not stem from the restraint on the deficit that was imposed by the program. Indeed, one of the features that the staff had tried to build into the program was an assurance of adequate funding for development programs, and to that end a commitment from the authorities to give priority to foreign-assisted projects had been built into the program. Unfortunately, that commitment could not be met, largely because of the shortfall in government revenue. It was very worrying that, within a broadly satisfactory overall budgetary performance in 1992, a structural difficulty, in the form of a revenue shortfall, had spilled over into reduced outlays on development projects. Efforts to redress the problem, through vigorous revenue mobilization, must be the central focus of the efforts to strengthen the budgetary position.

It was his understanding that the VAT and other tax measures currently before the Congress included mainly items that had originally been presented to the previous Congress and that so far little progress had been achieved in approving the proposed legislation, the staff representative remarked. The proposed reforms of the VAT dealt with monthly VAT filing and payment, expanding the scope of the VAT to include professional and other services, and improvements in administration and auditing.

The 5-6 percent growth target that the authorities were projecting for the medium term was, indeed, optimistic, the staff representative considered, although it was not unrealistic in terms of the experience of other countries in the region and the potential that existed in the Philippines. He was confident that the authorities would be pragmatic in their attempts to reach that target, and it would be unrealistic to expect any linkage between that target and the policies for 1993, especially with respect to the balance of payments. Clearly, any pickup in growth would have an impact on the current account of the balance of payments; the recent strength of the balance of payments was partly cyclical, stemming from the effects on imports of the slowdown in growth in 1991.

On the financing of the recovery, the staff representative continued, there were encouraging signs of increasing investor confidence, primarily from within the region, such as the Taiwan province of China and Singapore. Indeed, the inflows of capital into the Philippines from regional centers were indicative of a private sector-led resurgence in confidence that would underpin a pickup in activity in the period ahead. The balance of payments consequences of such a development would not be cause for much concern. The staff was concerned, however, about the need for an increase in public expenditures as an essential part of any pickup in activity over the medium term in the Philippines. There was a clear need for increased public spending on infrastructure investment on a very large scale, as in many countries throughout Asia, which was inevitably linked to the issue of domestic resource mobilization.

The staff projections for export growth in the medium term were somewhat optimistic, but not excessively so in light of the performance in the few years before the current recession, the staff representative stated. Prior to 1990, there had been a very substantial increase in exports in the Philippines, especially manufactured exports, following the structural adjustment in the export sector through the broadening of the manufacturing base and of export markets. Even in the difficult circumstances of 1992, with depressed world economic conditions and an appreciating real exchange rate, export growth of about 8 percent was being achieved. Moreover, the Philippines was clearly inspired in its export efforts by the experience of some of the better-performing countries in the region. Indeed, it was not an unreasonable aspiration for the Philippines to want to replicate the achievements of Thailand, Malaysia, Singapore, Hong Kong, and other economies, and the staff would encourage the authorities in that direction, as rapid growth in the manufacturing export sector had to be a part of their development strategy.

With respect to Mr. Evans's comments at the beginning of the discussion on the broad issues raised by the delays in completing the current review, it should be understood that the staff had been fully supportive of the authorities' efforts to complete the review as quickly as possible, the staff representative said. The staff had been ready to complete the review, which had originally been scheduled to take place by April 30, on time, following its successful discussions with the authorities in Manila in March 1992. Unfortunately, before the staff paper could be circulated to the Board, several policy slippages had emerged, associated mainly with the elections in May. The slippages had, at the very least, raised questions regarding the integrity of the fiscal program. Given the political situation at the time, the policy discussions that were needed to resolve those issues could not take place. Moreover, by the time the new authorities were able to provide assurances regarding their ongoing commitment to the program, slippages had extended to include also the monetary program. With the weakening of the monetary situation and the rise in inflation, the staff had not been in a position to recommend the completion of the review at that time.

In looking at the overall objectives of the stabilization program, containment of inflation was the key objective, the staff representative considered. The staff would emphasize that the deviations from the monetary program that had accrued were not insignificant. Moreover, the staff had neither been slavishly following a narrow set of monetary figures, nor "nit-picking" about performance relative to program targets. Rather, it had tried to assess monetary conditions against a broad range of indicators, which had confirmed the staff's belief that there had been a need for greater caution on the monetary side. Subsequently, the very firm measures that the authorities had taken in August and September had achieved a good measure of success in bringing the monetary situation back in line with the program. Performance in September was very close to the program targets, and the staff was pleased to be in a position to encourage the Board to complete the current review at the present time.

In supporting the authorities' request for a waiver of the end-September performance criteria, the staff had taken three factors, in particular, into account, the staff representative from the Southeast Asia and Pacific Department said. First, the staff supported the authorities' intention to conclude the debt operation with the commercial banks and so begin a new chapter with their commercial creditors. Second, there had been a long delay in completing the current review, and it would be unfair to penalize the authorities, given the large measure of control they had recently been able to achieve over the monetary aggregates, by asking for a further delay only because the Board discussion was being held after September 30, the latest date by which the review could be held on the basis of end-June performance criteria. In that regard, it was important to bear in mind that full data for end-September performance criteria would not be available until mid-November at the earliest. Third, the program had generally been successful, and it was fully deserving of the Board's support, even taking account of areas where slippages had occurred.

The Deputy Director of the Policy Development and Review Department recalled that Mr. Dawson and other Directors had asked about the apparent on-again, off-again approach of the authorities toward augmentation. In the staff's view, the authorities' approach had not been as equivocal as had been implied, as they had consistently expressed their interest in augmentation to the staff, although a request had not been anticipated at the present stage.

The commercial bank debt deal that the authorities hoped to complete in October 1992 would have a total cost of about $1.1 billion, the Deputy Director continued. In addition, the authorities had liquidated their foreign exchange swaps at a cost of about $500 million, which was a significant amount for the Philippines to finance, notwithstanding the level of its reserves. The staff was reasonably confident that a certain amount of financing for the debt deal would be catalyzed if the Fund were prepared to provide some augmentation, although the staff was not bringing a request to the Board at the present juncture. On the basis of the current discussion, however, the staff would envisage bringing the matter to the Board in early 1993, assuming that the program was still on track, with an indication of the overall financing plan, including the amount of financing to be provided by other sources and by the Philippines, which would probably be a substantial part of the package. On Mr. Al-Jasser's point about the possible need for management intervention on the issue of mandatory prepayment clauses, the Fund's views had already been conveyed very clearly to the banks at several stages of the process.

The provision in the proposed decision on exchange measures concerning approval of the exchange restriction evidenced by the existence of arrears in connection with the Paris Club agreement, which had concerned Mr. Végh, was a common feature in those cases in which there was a delay between the approval of the agreed minute and the signing of the associated bilateral agreements, the Deputy Director of the Policy Development and Review Department stated. For programming purposes, the staff did not regard those delays as arrears, but they could, nevertheless, give rise to an exchange restriction under Fund jurisdiction. It was normal in such cases for the staff to propose approval of the restriction through the expected period for completing the signings of the bilateral agreements.

Mr. Al-Jasser said that it was his understanding that it had been clearly explained to the authorities and the banks that the Fund would like to have the language of the commercial bank debt agreement indicate explicitly the distinction between voluntary prepayments and Fund repurchases pursuant to expectations or obligations. He wondered whether the staff believed that the final agreement would include the necessary language.

The Deputy Director of the Policy development and Review Department replied that Mr. Al-Jasser's understanding was correct that the Fund's views had been made clear to the authorities and the banks. The agreement had not yet been finalized, but the staff was fairly confident that the final language would be acceptable to the Fund.

The Acting Chairman remarked that both the banks and the authorities clearly understood that management would not propose that the Fund support the debt-reduction package unless the appropriate language was included in the agreement.

Mr. Al-Jasser said that the Acting Chairman's remarks were reassuring.

On the pressures that had led to the reduction in development expenditures, Mr. Al-Jasser continued, he agreed with the staff representative that it was important to ensure that the fiscal side of the program was strong enough to withstand such pressures in the future. In an alarming number of recent programs, unexpected pressures had emerged, and, even when measures had been taken to protect the fiscal side of the program, the development spending component of the budget had unfortunately suffered. He encouraged management and staff to examine more carefully, perhaps in cooperation with the World Bank, the effects of reductions in development expenditures on the long-term development of the economy, as well as on the disbursement of external financing from other institutions, with a view to shielding those expenditures from further cuts.

Mr. Végh said that he shared the concern expressed by Mr. Al-Jasser on the need for clarifying language in the Philippines' debt agreement, and he was reassured by the answer provided by the Deputy Director of the policy Development and Review Department on that point.

The staff representative from the Southeast Asia and Pacific Department noted that the authorities had already made a commitment in the letter of intent to try to structure their expenditure policies during 1992 so as to protect investment expenditures, including those in support of foreign assistance projects and other investment projects. Unfortunately, it had not been possible to meet that commitment fully, which was a reflection of the current structure of the expenditure side of the Philippine budget; nondiscretionary spending, especially debt servicing, represented a very large share of the expenditure side of the budget, and most of the remaining expenditures, such as on personnel, were extremely difficult to reduce. Given those structural limitations, the authorities had acted pragmatically in implementing the budget; indeed, it was difficult to see how they could have done better under the circumstances.

Mr. Marino said that he wondered whether the fact that clarifying language on voluntary versus obligatory prepayments had not been explicitly included in some earlier debt-reduction agreements could be interpreted as a recognition by the Fund that the relevant clause in those earlier agreements was not binding. He wondered whether inclusion in the debt agreement with the Philippines of explicit language on the Fund's preferred creditor status and its view that the expectation of a repurchase was not voluntary would weaken or strengthen the binding nature of the relevant clause in earlier agreements.

The Deputy Director of Policy Development and Review Department recalled that the Board, which had discussed the general issue of voluntary versus obligatory prepayments in 1990, had expressed the position that an early repurchase pursuant to an expectation was not voluntary. A number of earlier debt agreements had included the word "voluntary" in the relevant clause, which would be sufficient to protect the Fund's interests if all of the parties concerned agreed with the Fund's interpretation. However, it was not clear that the banks--or, indeed, the courts--would agree with the Fund's interpretation, and, ultimately, if matters got to that point, the court's interpretation would be final. In fact, it was clear that the banks did not agree with the Fund's interpretation, and, given the uncertainties regarding possible interpretations of the courts, the staff had pressed for clear language distinguishing early repurchases pursuant to obligations or expectations from voluntary repurchases for the purposes of prepayment clauses in commercial bank debt agreements.

Mr. Végh said that his personal view was that if such a case were taken to court by a creditor bank, the tribunal judge in, say, New York State would not agree with the Fund's interpretation that an expectation of early repurchase was a legal obligation under the statutes of New York State. Moreover, the fact that the clarifying language would be included in future bank agreements reinforced his position, which was shared by some governments and central banks, that the early repurchase expectation was not an obligation and that, therefore, a special waiver was required by the banks under the conditions of each agreement.

Mr. Evans remarked that he shared Mr. Végh's view on voluntary versus obligatory prepayments, but it should be clear that the Philippine authorities had shown no reluctance to support the Fund's approach on the issue, notwithstanding their misgivings about it; indeed, they had even said that they would be prepared to take the commercial banks to court themselves. The weakness in the Fund's approach to the issue was a reflection of the reluctance of creditor countries to take the issue up forcefully with the commercial banks.

Mr. Wei made the following statement:

At the previous review under the stand-by arrangement (EBM/92/27, 3/4/92), we were impressed by the authorities' progress in correcting major economic imbalances. Today, looking at the past year as a whole, we commend them for their firm commitment to the restoration of financial stability under very difficult circumstances.

Firm control over public finances has been achieved. The budget deficit was forced to narrow from 3.4 percent of GNP in 1990 to 2.1 percent of GNP in 1991. According to Supplement 1 of the staff report, the budget even recorded a surplus instead of a deficit, as initially estimated, for the first eight months 1992. Meanwhile, inflation declined continuously from a peak of 20 percent in early 1991 to about 7 percent in the early months of 1992, and it has remained at a single-digit rate since then. As confidence in the economy grew, the external position strengthened. There can be no doubt that these achievements are due in large part to the authorities' prompt action in ensuring adherence to the Fund-supported program. As the report shows, all the quantitative performance criteria, except for base money, for end-June 1992 were observed and, as a result of timely corrective efforts, base money was brought back closer to the target level.

In light of the authorities' perseverance with their adjustment policies and, consequently, the positive results, as well as the potential for further improvement in the economy, this chair supports the proposed decisions.

As we are in broad agreement with the staff appraisal, we have only two brief remarks. First, on public finance, the decline in the budget deficit, the size of the public sector borrowing requirement, the losses of the Central Bank, and the surplus of the OPSF are very encouraging developments. However, in view of the slack economic activity, the difficulties of major government corporations, such as the National Power Corporation, other uncertainties of revenue collection, and the impact of further spending cuts, the sustainability of these encouraging improvements remains a cause for concern. It is worrying that the recent sharp fall in revenue has been offset by a considerable cutback in development spending, which could adversely affect growth and development in the long term.

While commending the authorities for keeping a tight rein on expenditures, we strongly encourage them to intensify revenue enhancement. Measures listed in the report to improve tax administration and compliance are welcome. However, it is not clear to what extent these measures have contributed or can contribute to revenue enhancement.

Second, on monetary policy, we note that monetary management has not been an easy task owing to the complications caused by large foreign exchange inflows. Despite this, the authorities have continuously focused their efforts on keeping base money in line with the program target and on reducing inflation. The challenge now facing the authorities is to keep base money fluctuations to a minimum. We are encouraged by the authorities' recent timely actions in tightening monetary policy. We believe that the primary goal should be to reduce inflation, thereby providing a firmer base for the ongoing adjustment process.

Mr. Kural made the following statement:

The economy of the Philippines has performed well during the periods that preceded and followed the first peaceful transfer of political power in over two decades, which took place at the end of June 1992. During the periods immediately before and after the elections, however, this fragile balance was disturbed. All of the end-March performance criteria were met except for that for base money, which slipped owing to the effects of the national elections and the persistence of large foreign exchange inflows, especially during the first months of 1992. Nevertheless, we are reassured by the smooth transition of power that the authorities will continue their pursuit of adjustment by making strong efforts to safeguard the gains of their hitherto cautious approach and avoid major program slippages, which would be difficult to correct with policy actions.

The authorities' plans for the remainder of 1992 and 1993 include measures aimed at restoring growth, keeping overall public finances in line with the program path, and credit restraints to combat inflation. Planned external policy actions include measures for rebuilding the Philippines' net international reserves, completing the Philippines' financial arrangements with its external creditors, and concluding its commercial bank debt operation following completion of the current review under the stand-by arrangement.

The most recent available data indicate that the measures being implemented by the Philippines deserve the Fund's support. Accordingly, we support the decision to complete the review under the stand-by arrangement, which will enable the authorities to sustain and reinforce their adjustment efforts. This will give them an opportunity to correct the Philippines' financial and external imbalances, eliminate structural weaknesses, and build a good track record of program performance.

Deep structural changes, supported by proper macroeconomic policies, will be needed to put the economy on a growth path capable of providing a steady increase in real per capita income while resisting inflation. At the moment, however, neither the structural changes nor the appropriate policies are sufficiently advanced. To be sure, the Philippines has taken a significant step toward liberalizing its current and capital accounts and opening its economy to foreign investors and foreign competition, as reflected by the authorities' hope of moving to Article VIII status at a later date.

Although overall public finances are satisfactorily aligned with the program path, and the sizable shortfall in fiscal revenues has been matched by a sharp reduction of government spending, it is unfortunate that most of the cuts had to be made in the area of development spending and in other spending categories where restraint may be difficult to maintain during the second half of the year. Even though government subsidies are to be phased out, and even though the reduction of some ineffective public investment is justified, these cuts also threaten the prospects for future growth. The risk for growth was further magnified by last year's major import compression, resulting from the authorities' efforts to tighten their financial policies. For these reasons, the continuing decline of the investment/GDP ratio is cause for serious concern. The Philippine economy has always grown as long as massive foreign resources were available to the Government. But the intensity of recent indications pointing to an emerging recovery appears to be largely due to unutilized individual capacity dating from 1991, a factor that cannot be considered a permanent fixture. Would the staff please comment on this point?

The only solid basis for future growth is a dynamic private sector. The Philippines urgently needs to reorient its traditional private sector toward efficient and sustainable investment. In this area, the very recent measures removing all restrictions on current transactions and most capital items and the liberalization of the exchange, trade, and investment regimes should be helpful. Given the risk of policy slippages in the fiscal area, the Government must implement the agreed expenditure policies firmly and strengthen the permanent tax measures aimed at keeping the fiscal program on track. Otherwise, there is a risk that the policies liberalizing the financial market would provide an unwanted demonstration of the potentially destabilizing effects of deregulating the financial sector and liberalizing the capital account before inflation has been brought under control, fiscal discipline has been established, and exchange rate restrictions have been eliminated. We would urge the authorities to consider establishing new institutions that can efficiently implement genuine liberalization based on a broad social program, rather than one that aims only to motivate the private sector.

During 1991 and 1992, the Philippine authorities have demonstrated their willingness to address the serious economic problems inherited from the past. There is evidence that their efforts are beginning to bear fruit, and we strongly encourage the authorities to persevere. As the Philippines will continue to require multilateral and bilateral aid, some kind of economic reform will continue. The economy's ability to accelerate growth will depend on how fast it can absorb the necessary restructuring. This, in turn, will depend on the kinds of economic reforms that can be undertaken and on the successful maintenance of political stability.

Mr. Rubianes made the following statement:

As we agree with the thrust of the staff appraisal, we would like to comment only on the specific issue of augmentation. As Mr. Evans's illuminating statement pointed out, "the peaceful transition demonstrates a maturing democracy in the Philippines," and the commitment of the new Government to maintaining the objectives of the program gives us assurance that the stabilization process is consolidating and that a starting point for "market-based, growth-oriented" development is being established. One important element of the financing package of the program is the solution to the debt problem, which is aimed at paving the way for further voluntary lending operations. A condition for closing the agreement reached on May 14, 1992 between the Philippines and the commercial banks is multilateral support for debt and debt-service reduction, in accordance with the guidelines of the Fund.

The tight fiscal and monetary policies implemented by the Philippine authorities have kept the program on track, under difficult circumstances--the internal political environment during an election year and adverse external factors, such as the drought, affecting economic growth. The authorities' success is demonstrated by the fact that, by September, inflation had declined to less than 9 percent on a 12-month basis, the deficit of the consolidated public sector remains in line with the program, and important structural reforms were adopted in the areas of foreign exchange, trade, and investment, all of which deserve our appreciation.

These measures allowed the Philippines to meet all quantitative performance criteria for end-March and all, except base money, performance criteria for end-June. According to the recent information provided by the staff in EBS/92/153, Supplement 1, the end-September targets will also be reached.

Based on these factors, we would like to express our full support for the moderate augmentation requested by the Philippines, which is supported by the staff, as part of the current stand-by arrangement. We would hope that the Philippines would be able to make those purchases as soon as possible to facilitate the replenishment of its reserves.

Finally, we support the proposed decisions.

Mr. Dorrington recalled that at the previous review under the stand-by arrangement (EBM/92/27, 3/4/92), his predecessor, Mr. Wright, had made clear his chair's view that it was unwise for the Board to continue to support a series of weak programs on a regular basis for prolonged users of Fund resources, such as the Philippines. Mr. Wright had suggested that such an approach might even ultimately delay agreement on the strong policy measures that were urgently required. Mr. Evans, in the current discussion, had invited Directors to believe that, to a large extent, such measures were being taken and would continue to be taken; he hoped that Mr. Evans was right.

He agreed with much of what had already been said by previous speakers, Mr. Dorrington continued, especially with regard to both the Philippines' policy performance and the timing of the current discussion. On the wording of the commercial bank debt agreement, he supported those speakers who had argued for making the position of the Fund unambiguous in new debt agreements, which should not prejudice the interpretation of the Fund's unchanged position in earlier agreements.

He fully recognized that there had been a great effort on the part of the authorities--both before and after the elections--to keep the revised program on track, Mr. Dorrington commented. Their efforts in that regard should be commended. Most of the formal end-June performance criteria had been met, and it appeared that the end-September broad money target would be more or less achieved. While performance must be viewed with regard to the individual circumstances, he agreed with the general point that Mr. Dawson had made that ceilings should not be confused with targets. On the fiscal performance, although the Philippines had met the formal fiscal targets under the revised program, the way in which it had done so was less than ideal, which was nevertheless better than not meeting the targets at all. Cuts in development and investment spending were not compatible with sustained economic growth and development over the medium term. Revenue continued to be well below the expected levels; presumably, the new Government recognized that measures were needed to achieve higher levels of revenue.

The Philippines had only one chance to make a success of the debt-reduction agreement with the commercial banks, Mr. Dorrington considered. Implementing any debt agreement invariably meant making higher payments to creditors for a number of years, and such agreements should be entered into only when a genuinely credible and sustainable medium-term program was in place. His chair believed that the international financial institutions should be cautious about providing resources to support debt agreements before a good track record of sustainable adjustment had been achieved. He would have preferred to wait until there had been more convincing evidence that the Philippines' Congress was going to agree to measures sufficient to sustain performance into 1993 and well beyond.

As Mr. Wright had said at the previous review, it was not at all clear that drawings under the current arrangement were justified on balance of payments grounds, Mr. Dorrington stated. The new authorities' credibility with the Fund and other creditors would be substantially enhanced by successfully completing the program without making any drawings unless they were needed specifically for balance of payments reasons. In conclusion, his chair continued to have a number of reservations about the way in which the Fund's relationship with the Philippines was evolving. The proposed decisions were of an exceptional nature, and, notwithstanding the earlier delays, the rush to bring the review to the Board and to seek Brady deal enhancements required Directors to take a great deal on trust. He hoped that there would be substantial prior fiscal actions before any follow-up arrangement was brought to the Board. Nevertheless, it had to be recognized that the program had been kept broadly on track, if measured against the letter rather than the spirit of the arrangement. Consequently, after very careful consideration of all the issues, his chair could support the proposed decisions. Obviously, he would consider future proposals on their merits at the appropriate time. He wished the new Philippine authorities well; nothing would please him more than for the conditions to prevail such that he could be unambiguous in his support in the future.

Mr. Mojarrad made the following statement:

> As evident from the staff report and Mr. Evans's helpful statement, the Philippine authorities have achieved considerable success in restoring financial stability under the economic stabilization program initiated in early 1991 and supported by the current stand-by arrangement. We welcome the assurances given by the new Government that it will adhere firmly to the 1992 program targets and its desire for undertaking a successful growth-oriented program containing further structural reforms. We are in broad agreement with the thrust of the staff appraisal and its recommendations, and, therefore, we can support the authorities' requests for a waiver of the applicability of the end-September performance criteria, further extension of the period of the arrangement, rephasing of the remaining purchases, and purchasing the accumulated set-aside amounts. I will not comment on the

issues already covered by other Directors, but I would like to emphasize two points.

First, as indicated by the staff, the key element of the success of the program so far has been the authorities' efforts in strengthening public finances. However, in view of a sizable shortfall in government revenue during the first half of 1992, the new Government will need to face a challenging task on the fiscal front in the period ahead in order to stabilize the macroeconomic environment needed for further economic recovery. The staff reports that a cautious spending policy has succeeded in keeping the overall fiscal deficit in line with the program path so far this year. However, this expenditure restraint has fallen heavily on capital expenditure, including infrastructure projects, central to economic growth and development over the medium term. In order to enhance the efforts to improve revenue performance, the new Government should move rapidly and firmly to implement further steps to raise the additional revenues needed for the remainder of 1992 and tax reform measures. In this regard, we are pleased to learn from Mr. Evans's statement that under a cooperative working relationship with the new Congress, the authorities are hopeful that revenue-raising measures that were not acted upon by the previous Congress, as well as new measures in the areas of excise tax, VAT, and user fees and charges, will be passed.

Second, the new Government has still another challenge to meet, namely, to maintain the momentum for a robust and sustainable economic recovery and growth. This can only be assured when the climate for private investment improves. While accelerated public investment can provide an impetus to private investment, we believe that steps are required to enhance domestic savings and investment. However, the Government's debt burden has weakened the link between private savings and investment over the years. Although private savings have been growing in the past six years, a major portion of these savings has been used to cover the budget deficit. As a result, in order to finance the deficit and sterilize the impact of higher reserves on the money supply, the monetary authorities have issued treasury bills. These bills have been a major factor causing the Philippines' high interest rates--about 20 percent, the highest in the region--as they crowd out private investment and push up the cost of money. In this connection, it is important that the new Government undertake to quickly reform the regulatory environment for both domestic and foreign private investment.

We welcome the recent liberalization of the exchange rate, trade, and investment arrangements. However, bold structural measures should be pursued to open up the economy both internationally and domestically in order to direct the structure of the economy toward export-oriented growth and improved allocation of resources. In this connection, we encourage the authorities to eliminate the constraints that continue to hamper private sector initiative, including administrative regulations and restrictive labor legislation. We also urge the authorities to speed up the process of privatization of public enterprises. Given the fact that the Philippines is well endowed with all the necessary ingredients required for economic growth and development, including a skilled labor force, we are confident that the new Government can meet the challenges.

Finally, given the success of the stabilization program thus far, we look forward to the Board's consideration of the Philippines' request for a modest augmentation of the current stand-by arrangement. We wish the Philippine authorities every success in furthering their stabilization and reform efforts.

Mr. Posthumus remarked that he agreed with much of what Mr. Dawson had said. With respect to Mr. Evans's introductory remarks on the importance of establishing a track record with the Fund, Mr. Evans appeared to be concerned that the Fund had been overzealous in monitoring the performance criteria under the arrangement and that delaying the review, as a result of not meeting performance criteria, had obvious consequences for the decisions of other organizations. His own concern had been that, on the contrary, in such situations the Fund might unduly relax the performance criteria in order to prevent affecting adversely the decisions of other organizations. Clearly, the links that had gradually evolved between the decisions and programs supported by the Fund, on the one hand, and those supported by other organizations, on the other hand, could cause problems from two very different perspectives.

Like Mr. Esdar, he, too, was somewhat concerned about the tone of the reference in the staff appraisal to the effect that the staff looked forward to early discussions with the authorities on a successor arrangement, Mr. Posthumus said. The text was obviously supportive of a possible successor arrangement, and he wondered whether it was wise to include such remarks in a staff appraisal, because it was very difficult for the Board to judge whether there was sufficient reason for the staff's optimism. Furthermore, the beginning of the staff appraisal noted that the external position had continued to be strong and that reserves had been built up to a healthy level, which obviously raised the issue of balance of payments need. In that regard, he supported the point made by Mr. Esdar, which had also been made by several Directors at the previous review in March 1992, that there was a long history of Fund arrangements for the Philippines. Indeed, the staff report indicated that in recent years there had been a stand-by arrangement, followed by an extended arrangement and the current stand-by arrangement; his reading of the relevant sentence in the staff appraisal was that there could soon be a new extended arrangement for the Philippines as well. The staff should be more cautious in including such references in future staff appraisals. On Mr. Evans's request for Directors' reactions to a possible request for augmentation, he could agree in principle to support such a request.

Mr. Fridriksson made the following statement:

The Philippines has, on several accounts, performed rather well under the current program. I particularly note the narrowing of the current account deficit and the improvement of the consolidated public sector accounts. Strong effort should, however, be made to reverse the shortfall in revenues during the first half of the year. Problems also remain. Economic activity has been slack--although recent information indicates that a pickup may be under way--and inflation has rebounded somewhat, which underlines the importance of getting the recent rapid credit expansion under control.

On the structural front, I particularly welcome the liberalization of the exchange system and the adoption of more liberal rules for foreign investment. Overall, it is noteworthy that this has been possible in a period when a presidential election and a transition to a new government have taken place.

When the current arrangement was approved, this chair was rather critical of what we considered to be insufficient ambition. The better than programmed outcome in several areas can perhaps be taken as an indication that a tighter program aiming at an early achievement of external viability and a more rapid reduction of the Fund's protracted involvement would have been possible.

I welcome the prospect of an early conclusion of the comprehensive agreement with commercial banks, which in turn will pave the way for the Philippines' renewed access to international capital markets. In this connection, it is important to include in the agreement with the banks language that unambiguously distinguishes voluntary prepayments to the Fund from payments pursuant to expectations or obligations.

The reserve position of the Philippines remains comfortable, and it is questionable whether the drawing of the set-asides, or any drawing at all for that matter, is necessary.

On the augmentation of the arrangement, I agree with the comments of Mr. Dawson, Mr. Noonan, and others; and as far as the future relations between the Philippines and the Fund are concerned, Mr. Dawson's comments are relevant. The poor financial situation of the National Power Corporation is striking and continues to be a source of serious concern.

I can support the decisions as proposed.

The staff representative from the Southeast Asia and Pacific Department said that the declining investment ratio that had taken place over recent years had begun from a level that was unsustainable under the circumstances. The higher investment ratios in earlier years had been backed by higher fiscal deficits, and by levels of foreign borrowing that had been unsustainable. The larger fiscal deficits and increasing foreign debt had tended to undercut private confidence in the economy in view of the difficulties in sustaining financial stability. For the period ahead, it was clear that some recovery in the investment ratio would have to be an essential part of the future growth of the Philippine economy. Increased investment had to be built on a resurgence of confidence in the private sector, which was already beginning to take place, and the removal of the structural impediments that had constrained private investment in the past. In that context, he would emphasize the importance of building the recovery of private investment on a firm fiscal basis, grounded in particular on a noninflationary financial policy.

Mr. Evans made the following concluding remarks:

I would like to start by thanking Directors for the interest they have shown in this case and for their thoughtful comments and, in general, strong support. I was not at the previous meeting on the Philippines (EBM/92/27, 3/4/92); I was participating in another mission at the time. Since then, I have read the minutes of that meeting in full, and I must say, I found the comments today much more supportive of the Philippine authorities' efforts, as I think is deserved, because they have, indeed, stuck firmly with the program through a rather difficult election period. There was very little that was said that I would disagree with or that I think the Philippine authorities would disagree with. Their most difficult task is not accepting Fund advice on these matters; it is the task of selling that advice to a congressional system.

I would like to comment on just a few issues, the first of which is by now almost a peripheral issue. In his statement, Mr. Tabata expressed concern about having to waive the end-September performance criteria. Several other Directors expressed this concern as well. I must say, I fully share his views on this matter. I have spoken on this issue in other cases. I do not see this as being a good procedure for the Board, which is partly why I have raised the questions of when do we establish a track record and when do we bring a case to the Board. The only reason we had to waive the end-September criteria was that the case did not come to the Board before September 30. If the review had come to the Board, as it could have, before the end of June, we would have been conducting the same review on the basis of the end-March performance criteria, all of which were met. If we had conducted the review before September 30, we would have had to waive one of the performance criteria for end-June--namely, that for monetary policy, the target for which was missed by a small amount. As the matter was not brought to the Board before September 30, the Board is now asked to waive all of the performance criteria for end-September. This does not seem to me to be a sensible procedure. This was my point about taking a pragmatic view about when there is a track record that would justify bringing a case to the Board for consideration. I think the Board would have been in a better position had the case come to the Board earlier.

Turning from that procedural matter to the substance of the discussion, there are two closely associated issues. One is the very widespread concern expressed about the cutbacks in development capital expenditures and the other is the question of debt and augmentation. These issues are related. The Philippines certainly did not want to cut back on development expenditures, not least because they are, to a large extent, financed by external resources with very little effort on the Philippines' part. Nonetheless, a lot of these resources come in the form of lending and, hence, add to the fiscal deficit. But the authorities were faced with making a decision on how they should meet the fiscal targets in the situation they were in this year.

The authorities had a number of choices. They could have done what some countries do, the United States and Germany--they could have let the deficit go. But that is not an option under a Fund-supported program. They could have done what they would have preferred to have done and raised additional revenue, but it is very difficult to raise additional revenue in a congressional system during a presidential election year. They could have cut other expenditures, too. But one has to keep in mind--and this is the relationship with debt--that 40 percent of the Philippines' budget goes to debt service. This is why debt relief is so important in cases like this. This is why the Fund became involved in the debt strategy, because of the burden that debt service is putting on other expenditures, in particular development expenditures. When countries get into a situation of having to adjust the fiscal situation in the short term, they are often left with no choice but to cut back on development expenditures. It is not a very sensible strategy, but it is a strategy for which our procedures leave little choice.

Mr. Dawson said that the authorities have cannibalized the budget, especially capital expenditures. They could also have done what a number of other countries with severe debt problems have done and cannibalized debt-service expenditures. But the

Philippines has never done that; it has never gone into arrears on its debt payments. There has been enormous domestic political pressure for it to do so. Such pressure remains. Congress continually puts caps on the budget, particularly on debt-service payments. The previous President continually overrode those caps. The new President has declared that he will do likewise. It is in that context that these difficult choices the authorities face come down to having to cut the one expenditure they really want to maintain.

The relationship between the debt issue and augmentation derives from this difficulty, because part of the Administration's defense of maintaining debt-service payments has been the argument that it is only through making those payments that the Philippines will maintain the support of the international financial community--both the commercial banks from whom it hopes to borrow in the future and the international financial institutions, such as the Fund and the World Bank. The question of augmentation of the current arrangement has been with us from the outset of this program, because financing the program has always required debt relief both from the Paris Club on the official side and from the commercial banks. There has always been an expectation on the part of all of those closely involved in those negotiations that there would be a need for augmentation support from the multilateral institutions. That has been accepted all around. That has always been part of the Philippines' stance.

One can look at the situation now, when the pursuit of the program has delivered an external situation in which there may not be a balance of payments need--or in which it may be difficult to establish a balance of payments need--but we would never have gotten to that situation without the program and without the assumption of augmentation. If the augmentation had been given at the outset of the program, this issue would not arise now. That was not the case, however, because it was argued by the Board that augmentation required the establishment of a track record.

On the question of a successor arrangement, I think I would not be very far from the views expressed by Mr. Esdar. I think there is a real question about whether the Philippines needs a further Fund arrangement per se, but it certainly needs the support of development institutions like the World Bank, the Asian Development Bank, and other donors. None of those organizations is prepared to support countries like the Philippines without Fund support. It is not so much a question of the Philippines needing Fund resources; indeed, Fund resources are rather expensive at the moment, even the resources for debt augmentation. Incidentally, the amount that would be required by the Philippines would be less than 10 percent of the total outlay on the debt program, and no more than 20 percent of quota.

Unfortunately, our procedures--the linkages established between institutions--lock countries like the Philippines into Fund arrangements. They are very difficult to avoid. In fact, I think it is even difficult to avoid drawing under Fund arrangements. We could, as Mr. Esdar suggested, have a program without drawings. Other countries--Papua New Guinea in my constituency, for example--have done that. I think the Philippines is actually required to draw under a Fund arrangement before it can draw on its commercial bank credit. I also think that will probably be the ongoing situation. The vehicle for responding to that linkage seems to me to be the size of access. I would certainly caution against going the route that I have heard Mr. Goos propose in the past--and Mr. Esdar also supports it--of simply having Fund arrangements without access, because I think if Fund resources are not at stake with programs, we may find ourselves with weaker programs. We should think carefully about that.

If there is to be a successor arrangement, there is no doubt at all that energy will be an important element of that, the electricity situation in particular. That has been one of the major shortcomings on the public sector side in the past few years. One only has to go to the Philippines to see what a devastating effect the electricity situation is having on production in general, with almost daily shortages of power. But one might wonder how it came about. It is not something that occurred in a vacuum; it has a very distinct political linkage going back to the Marcos years. In fact, when there was the shift to democracy in the mid-1980s, there was a very strong backlash against power generation activities in the Philippines for a number of reasons, one of them being no more than the fact that one of the strongest people in the Marcos regime happened to be the Energy Secretary. There was a lot of questioning about how he came to hold that position, but the reaction was quite extreme.

The new democratically elected Government actually abolished the energy administration--not just the Secretary's position, but the whole administration. There has been a vacuum in decision making on energy matters ever since. The new Administration, I am told, has within only the last few days taken a decision to correct this situation. It is something that the previous Administration did not feel able to do, but the new Administration will be announcing, I understand, within the next week the appointment of a politically well-placed Energy Secretary and the establishment of a new Energy Department; there will be, together with that announcement, an announcement regarding electricity tariffs.

The Acting Chairman made the following summing up:

Directors were in broad agreement with the thrust of the policy analysis in the staff appraisal. They welcomed the additional progress made by the Philippines in the restoration of macroeconomic stability, as evidenced by a strengthening of the external position, the containment of the fiscal deficit, and lower inflation. As a result, the outlook for the Philippines appeared brighter than it had been for some time. The generally favorable performance and prospects were particularly notable in view of the natural calamities that struck the Philippines in 1991/92 and the uncertainties associated with the electoral period.

Directors welcomed the commitment expressed by the new Administration to the economic stabilization program supported by the stand-by arrangement. They observed that the smooth political transition would serve to strengthen confidence and thereby enhance the prospects for a sustained strengthening of the Philippines' track record. Nevertheless, Directors stressed that creating an environment for faster growth in the medium term--in line with growth rates in the region and with the potential of the Philippine economy--would require not only the sustained pursuit of financial stability but also more decisive and broader efforts to remove structural impediments.

Directors welcomed the reduction in the overall public sector deficit achieved in 1991 and the authorities' determined efforts to keep within the fiscal targets of the program for 1992. They were concerned, however, about the continued weakness in the structure of the national government finances and certain key public sector corporations. Directors commended the authorities for exercising tight control over expenditures in response to the sizable shortfall in revenue. However, many Directors also underscored the risks for future growth if the development expenditure component of the budget continued to bear the brunt of the cutbacks, which Directors viewed as an unsustainable strategy. For this reason, Directors expressed concern about the delays in implementing the revenue and tax reform measures, and they urged the authorities to act without delay on the steps already contemplated under the program as well as on additional revenue-raising actions.

Directors underlined the importance of improvements in the performance of the rest of the public sector, especially the nonfinancial public corporations and the operating position of the Central Bank. In this connection, they welcomed the authorities' plan in the energy sector to deregulate oil prices and introduce greater flexibility in the setting of energy prices, including electricity tariffs, for which a further sizable increase will be needed. It was crucial that this latter step be pursued to restore the financial position of the National Power Corporation and allow for the needed improvement in electricity supply. Directors also stressed the need for early action to rehabilitate the Central Bank and thereby improve the effectiveness of monetary management and reduce the fiscal deficit.

Directors expressed concern that the uneven implementation of monetary policy during the electoral period and the difficulties posed for monetary control by large capital inflows had led to continued problems in meeting the money growth and inflation objectives of the program. Directors believed that the persistence of inflation underscored the need for adhering to the monetary program. They recognized that high nominal interest rates, combined with a strengthening of confidence, had put upward pressure on the peso, but they emphasized the importance of maintaining appropriate financial policies aimed at keeping inflation low as the cornerstone for safeguarding the competitiveness of the Philippines' exports. With the consolidation of financial stability and the improvement in the fiscal position, interest rates could be expected to decline and upward pressures on the peso ease.

Directors commended the authorities for their bold action in removing most remaining restrictions in the exchange system and in taking further steps to liberalize trade and foreign investment. These actions had contributed to improved prospects for the external payments position over the medium term, as well as improving the prospects for growth. Some speakers encouraged the Philippines to move to Article VIII status in the Fund.

Directors welcomed the debt-restructuring agreement reached with commercial banks, involving debt and debt-service reduction elements. Completion of this debt operation would be a major step forward in the normalization of the Philippines' relations with its commercial creditors and would permit the Government to consider re-entering the international capital markets. Consistent with the Fund's guidelines for supporting debt and debt-service reduction operations, Directors agreed that the release of the designated set-aside amounts under the program was appropriate. Directors indicated their support, in principle, for considering further Fund financial assistance for the debt operation in the form of an augmentation of the stand-by arrangement, contingent on continued satisfactory performance under the program during the remainder of 1992. Directors also noted that even after the commercial bank debt operations are concluded, debt and debt-service payments would still be relatively large in the case of the Philippines, which further underscored the importance of maintaining sound monetary and fiscal policies and strengthening the prospects for growth.

It is expected that the next Article IV consultation with the Philippines would be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Exchange Measures Subject to Article VIII

1. The Fund takes this decision relating to the Philippines' exchange measures subject to Article VIII, Section 2(a), in light of the 1992 Article IV consultation with the Philippines conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The Philippines maintains a restriction on the making of payments and transfers for current international transactions evidenced by external payments arrears subject to Fund approval under Article VIII, Section 2(a). In the circumstances of the Philippines, the Fund approves the retention by the Philippines of the restriction that remains pending the finalization of the bilateral agreements with Paris Club creditors until December 31, 1992.

Decision No. 10160-(92/122), adopted
October 7, 1992

Review Under Stand-By Arrangement

1. The Philippines has consulted with the Fund in accordance with paragraphs 4(b) and (c) of the stand-by arrangement for the Philippines (EBS/91/17, Sup. 3, 2/26/91) and the fourth paragraph of the letter of the Governor of the Central Bank of the Philippines and the Secretary of Finance, dated February 10, 1992 (EBS/92/24, 2/11/92).

2. The letter of the Governor of the Central Bank of the Philippines and the Secretary of Finance, dated September 15, 1992, with attached table and supplementary memorandum, shall be attached to the stand-by arrangement, and their letters dated February 5, 1991, February 10, 1992, and September 4, 1992, with annexed memoranda, shall be read as supplemented and modified by the letter dated September 15, 1992, with attached table and supplementary memorandum.

3. Accordingly,

a. Paragraph 1 of the arrangement shall be modified by replacing "December 31, 1992" with "March 31, 1993."

b. Paragraph 2(a) of the arrangement shall be modified by replacing "the equivalent of SDR 226.5 million until November 1, 1992" with "the equivalent of SDR 207.6 million until February 15, 1993."

c. The performance criteria as specified in paragraph 4(a) of the arrangement for December 31, 1992 shall be as set forth in Table 1 attached to the letter dated September 15, 1992.

4. The Fund decides that the second and third program reviews and the associated financing reviews contemplated in paragraphs 4(b) and (c) of the arrangement are completed and that, notwithstanding that data for the performance criteria for September 30, 1992 are not available, and that the Philippines has imposed an exchange restriction evidenced by external payments arrears, the Philippines may proceed to purchase up to the equivalent of SDR 42.45 million.

5. a. The Philippines has requested that the Fund make available, in accordance with paragraph 2(c) of the arrangement, the equivalent of SDR 51.9 million, representing the set-aside amounts that, pursuant to paragraph 2(c) of the arrangement, (i) were made in the purchases already made under the arrangement (SDR 37.75 million), and (ii) are to be made in the purchase to be made available upon completion of the present review (SDR 14.15 million).

b. The Philippines has also requested that the Fund, with respect to the purchase to become available after February 14, 1993, discontinue the designation of amounts for debt reduction in accordance with paragraph 2(e) of the arrangement.

c. In light of the request referred to in paragraph 5(a) and the representation of the Philippines, the Fund has reviewed the financing of the Philippines' program supported by the arrangement and determines that the debt reduction involved is consistent with the objectives of the program and that the purchase of the amounts referred to in paragraph 5(a) is needed for the replenishment of the Philippines' reserves in connection with the Philippines' debt reduction operation.

d. Accordingly, the Fund decides that (i) the amounts referred to in paragraph 5(a) above shall be available to the Philippines under the arrangement; and (ii) with respect to the purchase that is to become available after February 14, 1993, there shall be no designation of amounts for debt reduction.

Decision No. 10161-(92/122), adopted
October 7, 1992

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/92/121 (10/5/92) and EBM/92/122 (10/7/92).

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 92/28 through 92/31 are approved.

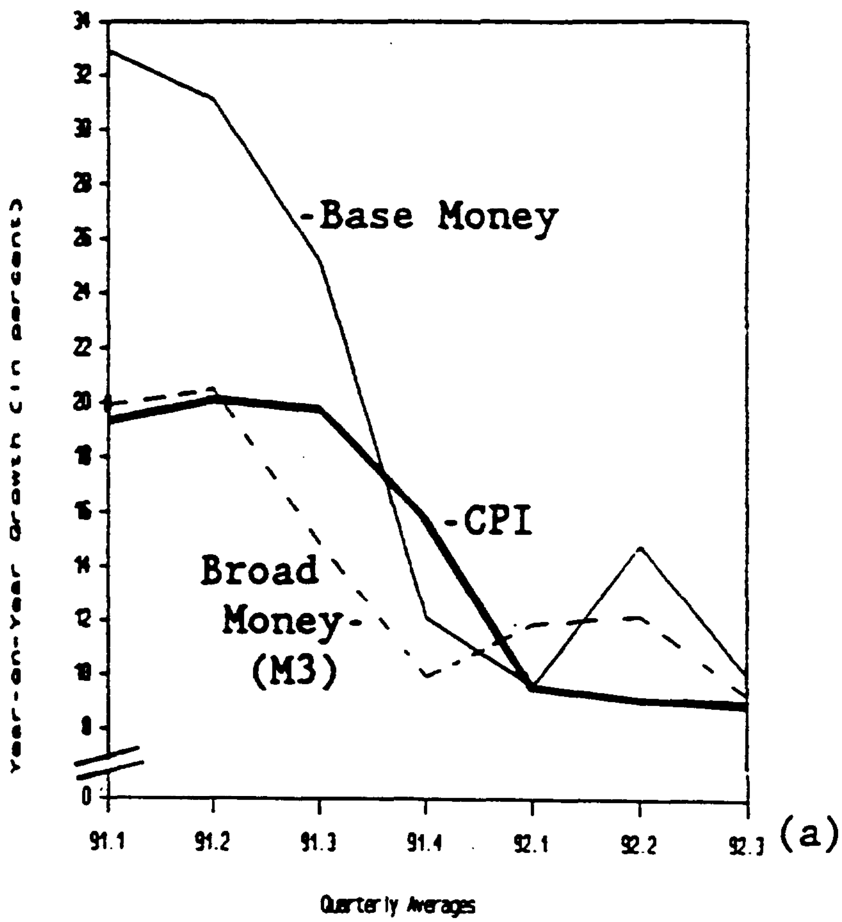
4. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAM/92/88 (10/5/92) is approved.

APPROVED: April 20, 1993

LEO VAN HOUTVEN
Secretary

Monetary Growth and Inflation



(a) M3 to July; Base Money to August.