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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/97

3:00 p.m., June 20, 1988

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
F. Cassell	C. Enoch
Dai Q.	
	D. C. Templeman, Temporary
	E. L. Walker, Temporary
J. de Groote	
A. Donoso	
	M. B. Chatah, Temporary
G. Grosche	
	D. V. Nhien, Temporary
A. Kafka	
	C. L. Haynes, Temporary
	J. Gold, Temporary
	K. Kpetigo, Temporary
	I. A. Al-Assaf
	C. Noriega, Temporary
	M. Fogelholm
	G. Pineau, Temporary
	C. C. A. van den Berg, Temporary
C. R. Rye	
G. Salehkhou	
	A. Vasudevan, Temporary
K. Yamazaki	N. Adachi, Temporary
S. Zecchini	

C. Brachet, Acting Secretary
D. J. de Vos, Assistant

Also Present

IBRD: N. L. Hicks, Asia Regional Office; J. Sackey, Latin America and the Caribbean Regional Office. Asian Department: P. R. Narvekar, Director; U. Baumgartner, D. J. Goldsbrough, B. Gurgen. Exchange and Trade Relations Department: H. B. Junz, Deputy Director; S. Kanesa-Thasan, K. P. Regling. Legal Department: P. L. Francotte, A. O. Liuksila, J. V. Surr. Treasurer's Department: D. Berthet, J. E. Blalock. Western Hemisphere Department: M. Caiola, Deputy Director; J. Ferrán, Deputy Director; C. G. Muñiz B. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. A. Agah, E. Ayales, S. M. Hassan, K.-H. Kleine, P. Péterfalvy, M. Pétursson, J. E. Zeas. Assistants to Executive Directors: F. E. R. Alfiler, D. Barr, F. El Fiky, M. Hepp, L. M. Piantini, S. Rebecchini, S. Rouai, G. Seyler.

1. PHILIPPINES - 1988 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/88/96, 6/20/88) their consideration of the staff report for the 1988 Article IV consultation with the Philippines (SM/88/113, 5/25/88; and Cor. 1, 6/15/88). They also had before them a background paper on recent economic developments in the Philippines (SM/88/121, 6/6/88; and Sup. 1, 6/6/88).

Mr. Haynes said that during the previous two years the authorities had demonstrated commendable commitment to a program of adjustment and structural reform. As a result, economic activity had recovered strongly and had been sustained into the first half of 1988. Economic reforms had had a favorable impact on investor confidence, and after several years of decline, the investment to GDP ratio was rising again. The inflation rate was currently in single digits, while the fiscal and external imbalances had been reduced substantially.

Despite those achievements, however, the authorities faced a challenging and difficult period ahead as they sought to maintain the delicate balance between their domestic and external objectives, Mr. Haynes continued. The preliminary medium-term scenario pointed to the possibility of a further deterioration in the external current account, continuing high debt service payments, potentially large financing gaps, and only gradual improvement in the import reserve cover. At present, the export projections appeared to be optimistic, and the authorities needed to develop a sustained marketing strategy while paying careful attention to the question of competitiveness. In the circumstances, continued reduction of the inflation rate would be crucial, but despite the progress achieved thus far, it was not clear that the economy was on a low inflation rate path as prices had been on an upward trend during recent months. While some of those increases reflected administrative price adjustments, the underlying inflation rate appeared to be rising as a result of excessive domestic demand, and should be monitored carefully.

Given the rising inflation rate, the shift to tighter bank liquidity in the first part of 1988 was appropriate, while the authorities' intention to maintain a cautious monetary policy stance for the remainder of the year was welcome, Mr. Haynes considered. However, internal and external objectives could be attained most efficiently if monetary and fiscal policy worked together, rather than having the present stance in which monetary policy sought to counteract the overexpansionary fiscal policy.

The staff report noted the difficulties associated with implementing monetary policy as a result of the Central Bank's previous quasi-fiscal activities, Mr. Haynes remarked. The replacement of central bank bills by treasury bills was welcome, but he stressed that it was important to achieved the planned sales of the latter to avoid a recurrence of the surge in money growth of late 1987. He supported the staff's suggestion that the debt service burden be transferred to the Treasury, which could initially take the form of an explicit transfer to the Central Bank to finance the cost of those operations. Over time, the transfer of the debt service could help to impose greater financial discipline on the Government.

At the Board's previous discussion of the Philippines in March (EBM/88/34 and EBM/88/35, 3/9/88), when Directors considered an extension of the country's stand-by arrangement, his chair had supported the view that the use of the exchange rate to shore up falling reserves might have contributed to a further speculative outflow of capital, Mr. Haynes recalled. However, the authorities should be wary about relying excessively on monetary policy to influence the exchange rate, particularly if it became clear that the economic fundamentals dictated a somewhat different level for the rate. The authorities' commitment to a flexible exchange rate policy in response to developments in external competitiveness and in the balance of payments was welcome.

Given the current strength of the economy, the fiscal policy stance in 1988 appeared to be too expansionary, Mr. Haynes noted, with the consolidated public sector deficit anticipated to rise by 2.5 percentage points of GDP. Limiting the expansion of the fiscal deficit would assist the authorities to maintain a level of demand that was consistent with external and internal balance and would be in keeping with their original plan to withdraw fiscal stimulus as the recovery gained strength.

Part of the fiscal adjustment should be achieved through a review of planned expenditure, Mr. Haynes stated. At present, the downward revision of growth in capital expenditure was realistic given the authorities' low implementation capacity, but over the medium term, it would seem to be desirable to raise the ratio of public investment to GDP. The development of an effective system for identifying and implementing appropriate projects would be crucial in fostering the economy's long-term growth potential. Equally important, however, was the control of current expenditure. The strong growth in personnel expenditure in 1988 seemed to be excessive given the existing resource constraints; but it was clearly a sensitive issue, especially since the salary structure needed to be improved. In any event, it might have been more prudent to follow a more gradual approach to adjusting public sector wages.

With respect to the revenue side of the budget, the authorities had undertaken a major tax reform resulting in improved buoyancy of the tax system during 1986/87, Mr. Haynes observed. However, despite the introduction of a value-added tax, the ratio of tax revenue to GDP was expected to decline in 1988. It was clearly too early to determine the permanent impact of the new revenue measures, but the authorities would have to continue to focus their efforts on widening the tax base and on improving tax administration.

Progress had been achieved in each area of structural reform and had been quite impressive in some cases, Mr. Haynes commented. It was gratifying to see that detailed privatization plans had been completed for a number of nonfinancial public corporations, which would hopefully clear the way for an increase in the pace of actual privatizations. The substantial progress made in trade policy reform to reduce significantly import restrictions was also welcome. However, the existence of development programs for the production of items that still faced quantitative import restrictions was a cause for concern. Moreover, the authorities had indicated that those programs might be extended to other items. Those programs might create disincentives to the future relaxation of import controls and might encourage the inefficient allocation of investment resources.

The Philippines would require substantial international assistance over the medium term, while the authorities' continued commitment to adjustment would remain critical, Mr. Haynes concluded. He would be interested to find out what type of Fund-supported program in the future the authorities were contemplating.

Mr. Kpetigo made the following statement:

> The staff report indicates that the Philippines continues to respond favorably to the far-reaching macroeconomic and structural adjustment measures that the authorities have been implementing with Fund support. After the serious economic and financial crisis of the early 1980s, the Philippine economy has begun to recover markedly: during the previous 18 months, growth of domestic output has remained vigorous, with internal and external imbalances having been brought under control.
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> Despite this remarkable achievement, for which the authorities deserve commendation, the economy is not yet invulnerable. The most important challenge facing the authorities at present is to maintain the economic recovery while continuing the structural reforms and further reducing economic and financial imbalances.
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> With respect to the fiscal sector, I have noted the shift in the composition of government expenditures, and I agree with Mr. Rye's explanation in his opening statement for the recent increase in wages and salaries. However, the decrease in capital expenditure is a cause for concern, and I share the staff's view that "the shift in expenditure composition is detrimental to both growth and adjustment." The authorities should, therefore, take the necessary steps to reverse this unfavorable trend and thus restore capital expenditure to a level that is consistent with the objective of growth.
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> Important structural reform measures have been taken in the sugar and coconut sectors as well as in government financial institutions. These measures have already resulted in improved income distribution, reduced rural poverty, and lessened pressures

on the public finances. Maintenance of the thrust of these policies will help to make the environment more conducive to enhanced private sector activity and investment.

The medium-term balance of payments scenario indicates that there will be an average annual financing gap of more than $2 billion. Moreover, the external debt represents about 82 percent of GNP. The authorities are successfully implementing a debt-to-equity conversion scheme, but concern still exists about how quickly and significantly they can curb the current account deficit to achieve a swift and strong economic recovery. Given the fact that the debt service ratio stands at more than one third of export earnings, one wonders about the prospects for covering the financing gap. In any event, that gap underscores the need to provide further concessional assistance to the Philippines. In this context, the revitalized extended Fund facility could play an important catalytic role in attracting additional capital flows. The Philippines deserves strong financial support from the international community.

Mr. Vasudevan made the following statement:

I generally agree with the broad thrust of the staff appraisal.

The strengthening of real GNP growth in 1987 was largely caused by a strong increase in private consumption, although there was also a sizable expansion of gross fixed investment as well. However, there is a large amount of unutilized capacity. As export volume growth is expected to be limited in 1988, real private consumption growth will have to provide an impetus to growth in 1988 as well, which is well reflected in the fact that in real terms private consumption is projected to go up by 4.1 percent in 1988 against a 5.5 percent rise in 1987. It is, however, not clear how this consumption rate can be sustained by a deceleration in import volume that at 8.6 percent in 1988, will be hardly one third of the growth of import volume in 1987. The staff may wish to comment on this point.

The implications of rising real private consumption need to be examined carefully. Such an increase may not take place without wage increases, greater employment, and a rise in administrative prices. Since the growth rate cannot accelerate without having a sizable rise in private consumption, it appears as though the fiscal budgets may have to facilitate a rise in consumption expenditures. However, if fiscal policy is strongly geared to containing personnel expenditures and to raising capital expenditures, it may still have an effect on real output growth, but perhaps only with a time lag. The authorities seem to have struck a reasonable balance in the expenditure pattern, and have generally focused on investment expenditures that give rise to quick agricultural output growth and skill formation. In this area, I note that the World Bank's initial concerns about the investment pattern have been largely addressed.

There is little discussion in the staff report on how the pattern of public expenditures will affect private investment intentions and responses. I presume that such a transmission occurs through the structural policy area, in which the Philippines has made commendable progress. In his opening statement, Mr. Rye indicates that the improved quality of adjustment has increased efficiency, which he says has contributed to accelerating growth. While this may be true, it is still not clear whether the private sector is buoyant or ready enough to invest on a scale that would compensate for the slack in public sector investment. I would appreciate some staff comment on these concerns.

The surge in the inflation rate--facilitated to some extent by a rise in domestic liquidity, particularly during the last quarter of 1987--is serious cause for concern. I agree with the staff that monetary policy alone cannot handle this problem; but, at the same time, giving too much emphasis to interest rate policy would hardly be a proper response. Financial restraint, coupled with structural reforms, will be the only means of eventually reducing the inflation rate. It is in this context that the authorities will need to exercise considerable judgment in pursuing a flexible exchange rate policy.

The adjustment program is generally on track, and I commend the authorities for the progress achieved so far. However, for adjustment to be more effective and successful, the international community will have to view the authorities' problems with considerable sympathy and understanding. Rescheduling of debt and new means of tackling the debt problem, including debt-to-equity conversions, are clearly required and should lead eventually to a reduction in the debt service burden.

Mr. Dai made the following statement:

The recovery in the Philippine economy continued to gain strength in 1987 as real GNP grew by 5.7 percent, the highest rate since 1979. While the economic turnaround in 1986 was attributable mainly to the rise in exports, in 1987 it resulted essentially from strong domestic consumption and investment demand, which led to a further strengthening of the recovery. It is particularly heartening to note that investment, after five consecutive years of decline, has rebounded significantly. In the external sector, export growth remains buoyant and the debt situation has eased. Sound macroeconomic policies and comprehensive structural reforms are evidently the major contributing factors behind these remarkable achievements, for which the authorities deserve great commendation.

With respect to the overall economic situation, the strongly rising trend in demand should be monitored. The growth in domestic demand has already put pressure on prices and on current payments: the inflation rate accelerated in 1987 and is likely to rise further in 1988, while with imports rising at nearly double the rate of exports, the current account deficit has widened markedly and is expected to increase further. Monetary policy has been tightened to cope with demand pressures, and although this tightening appears to be necessary at the moment, the impact of the resulting higher interest rates on investment and the exchange rate should be monitored carefully. In this respect, the staff is correct that fiscal policy is the key area in which strong measures need to be taken to further reduce the budget deficit, particularly recurrent expenditures, which, owing to a number of specific factors, increased substantially in 1987. Fiscal adjustment will not only alleviate inflationary pressures without impairing the investment momentum, but will also contain the increasing demand for imports, and hence improve the external payments position.

The financing gap in the medium-term balance of payments scenario over coming years will still be substantial, and the debt situation will probably remain grave. To manage the debt, the authorities intend to pursue a strategy involving the provision of new money and the use of debt exchanges, the latter of which will reduce the debt. Strong support from the international community is crucial, and I hope that an adequate capital flow will be forthcoming to support the authorities' efforts to resolve the debt problem successfully.

The President of the United States recently called for more international assistance to the Philippines; I wonder whether the staff can provide some information on the concrete contents of any aid program.

As agriculture affects a large part of the Philippine population, I wish to reiterate the important role that land reform can play in strengthening the economy, relieving rural poverty, and enhancing social stability. Therefore, it might be advisable for the authorities to accelerate the implementation of the land reform program that was recently signed into law by the President of the Philippines.

Mr. Salehkhou made the following statement:

The impressive economic recovery of the Philippines has certainly gained international recognition. During 1987, the comprehensive Fund-supported economic program--which commenced in early 1986--was strengthened, and further progress was made toward achieving major objectives.

To ensure the sustainability of growth, wide-ranging structural reforms in the areas of taxation, trade, finance, and agriculture were implemented. Despite a severe drought, political disturbances, an unfavorable external environment, and financial difficulties, real GNP grew by 5.7 percent owing largely to the strength of the recovery in manufacturing and construction activities. Furthermore, the emphasis of industrial policy was shifted from the earlier focus on heavy, capital-intensive, and often wasteful schemes, to light, labor-intensive, small, and medium-scale projects. While during the final quarter of 1987, investment was concentrated mostly in private construction and the rebuilding of stocks, the stronger growth in both consumption and investment reflected the revival in domestic demand. At the same time, close cooperation with the international financial community was maintained and major new balance of payments problems were avoided. Moreover, as the economic recovery gained strength, the unemployment rate declined from 11 percent in 1986 to 9.5 percent in 1987, an improvement that was even more pronounced in the urban areas--mainly reflecting larger employment increases in the manufacturing, trade, and service sectors.

However, by the end of 1987, agricultural shortages induced by severe drought, along with the effects of increased domestic demand raised the inflation rate to 7.5 percent. In the fiscal area, although the revenue performance was favorable, as reflected in increases in government revenue collection and internal cash generation by public corporations, higher current spending in conjunction with the planned sharp revival in public investment maintained a high level of expenditure growth--which appears to be the staff's principal concern. Interest rates, which had fallen in the first quarter of 1987, rose toward the end of 1987, apparently in response to the tightening of monetary policy and an increase in the inflation rate. The external position deteriorated owing mainly to the weakening of confidence in the wake of an attempted coup in August 1987; and despite a strong export performance, the external current account moved from a surplus into a deficit, and gross international reserves declined.

However, according to Mr. Rye in his opening statement, there is every indication that growth will remain strong in 1988, and that with respect to the medium-term objectives, the authorities will remain firmly committed to implementing structural reforms and to making serious efforts to remove impediments related to program implementation. As the staff has observed, the authorities are well aware of the challenges that lie ahead and of the economy's susceptibility to both internal and external shocks. Of course, the attainment of sustainable growth and a viable external position requires not only a forceful adjustment policy, but also a favorable external environment that is complemented by strong support from the international financial community.

Since I broadly concur with the staff appraisal, I will only make a few specific points. I appreciate the staff's principal concerns in the area of fiscal policy, where some slippage has resulted from the sharp increase in personnel expenditure. This increase, according to the staff, "not only aggravates the pressure on prices and the balance of payments, but also worsens the outlook for fiscal adjustment over the medium term." However, I also sympathize with the authorities' contention that the salary increases were intended to partly offset the decline in real salaries that occurred during previous years and to enable the Government to attract and to retain the most qualified personnel, notwithstanding the fact that the lowest wage in the civil service will still be some 25 percent below the poverty level. The authorities' concern with salaries is well founded and appears to be fully consistent with the Fund's own recruitment and compensation policies, as Mr. de Groote also noted.

The recent signing into law of the land reform bill is welcome. The reform has become rather controversial in terms of its coverage and adequacy, and is thus undoubtedly a politically sensitive issue. This is especially true with respect to the population in the south of the country, a minority that continues to remain the poorest and that suffers from injustices. In view of the importance of the agricultural sector in the Philippine economy, which, together with the economy's traditional exports, determines the country's long-term capacity to sustain growth and to achieve balance of payments viability, the authorities may wish to consider the land reform law as only a first step and to think about further extending its coverage, perhaps in a more gradual and just manner to avoid further political instability. It is to be hoped that the international community will respond favorably by providing the needed external resources for the implementation of this crucial agrarian reform.

Finally, it appears that external debt roughly equals the amount of capital that surreptitiously left the Philippines during the previous regime. The welcome sympathy expressed by certain industrial countries and by major financial centers for the new Government during its initial months in office, with respect to the repatriation of capital flight, appears to be waning at present. I recall the request that I made during the Board's discussion of the review of the stand-by arrangement in March 1987, that this important matter be addressed specifically by the staff, a request that has regrettably not been covered in the present staff papers. I wonder whether the staff is in a position today to shed some light on the size and the amounts involved in the capital flight and on any recent developments or tangible results from the host countries' promised cooperation in repatriating the capital. If not, I do hope that the staff would consider the subject important enough--especially in view of its implications for debtors and other less developed countries--to give it sufficient coverage during the continuation of the seminar on the legal effects of the approval or nonapproval of exchange restrictions, using the Philippines as reference case. This clearly is fully in line with the Fund's assumed central role in the debt strategy.

The Chairman said that the staff would provide Mr. Salehkhou with the information that he had requested, but the issues involved in the seminar on the legal effects of approval or nonapproval of exchange restrictions by the Fund were already so complicated that he questioned whether the case of the Philippines could be included among them.

Mr. Al-Assaf made the following statement:

The authorities should be highly commended for implementing a strong economic recovery program in the context of a viable financial position; special commendation is also due for their achievements on the structural and trade fronts.

As the authorities continue with the adjustment process, the challenge facing them is to further enhance the confidence of domestic and international investors in the economy. Investor confidence will be facilitated by the continuation of the reforms in the structural and trade areas. Realizing the authorities' objectives will also require further strengthening of the current account position, improving fiscal performance, and building up gross official reserves.

Like the staff, and most preceding speakers, I am somewhat worried about the fiscal policy slippages that have occurred recently. In particular--although I understand the Government's political concerns and the points raised by Mr. Rye and Mr. de Groote--the sharp increase in personnel expenditure and its adverse impact on investment expenditure is alarming. This is especially so when we think of the investment needed for the attainment of medium- and long-term growth objectives.

It is difficult to take sides on the apparent differences between the authorities and the staff on the appropriate mix of monetary and exchange rate policies needed to maintain internal and external balance. On the one hand, I agree with the staff that although a tighter monetary policy is necessary to contain inflationary pressures, that policy should not be relied on too heavily as it will have an adverse impact on investment. On the other hand, Chart IV in the staff report--which shows the movement of the real effective exchange rate vis-à-vis the country's trading partners and competitors--supports the authorities' stand. The chart indicates that the real effective exchange rate has declined vis-à-vis the former group, and has been maintained with respect to the latter. The strong increase in exports reinforces this point as well. Furthermore, the reversal of the authorities' policy of intervention in early February 1988 did not lead to a significant movement in the exchange rate. At this stage, there is an increased need for a closer monitoring of exchange rate developments and for flexibility in exchange rate policy, which the authorities intend to do. The authorities should concentrate primarily on fiscal policy while, at the same time, continuing the structural and trade reforms, which will go a long way toward achieving the seemingly contradictory objective of containing inflation, providing the right environment for investment, and expanding exports.

Mr. Zecchini said that progress in several areas continued to characterize the economic performance of the Philippines in 1987 owing to the authorities' commitment to implementing their medium-term adjustment program. Especially noteworthy was the authorities' timely implementation of the structural reforms required under the program. However, the medium-term projections indicated that substantial difficulties remained to be overcome, especially in the external sector. Those difficulties pointed to the need to maintain the current strategy, which had proved to be effective in allowing a coupling of adjustment and growth. The consolidation of the recovery was required to further strengthen private investment and to keep the inflation rate and excessive domestic consumption under control.

Fiscal policy would continue to play a crucial role in the attainment of the stabilization and growth objectives, Mr. Zecchini continued. To that end, improvements in the composition of public expenditures and a further reduction of the budget deficit were needed. The recent deterioration in the composition of budget outlays owing to the expansion of public wages and the scaling down of capital expenditures was somewhat of a cause for concern. The staff reported that the shortfall in public investment--which was expected to remain below the target level of 5 percent of GDP--resulted mainly from implementation bottlenecks. Additional information by the staff on the nature of those bottlenecks and on the type of remedies being considered by the authorities would be welcome.

Recent projections indicated that the fiscal deficit targets for 1988 would be met, Mr. Zecchini noted. Nevertheless, the deficit would still be significantly above its level of 1987. Therefore, in the coming years, renewed efforts should be made to resume the process of budget consolidation to free resources for private investment and to reduce pressure on interest rates. To that end, room for maneuver was provided by the relatively low level of revenues as a percentage of GDP. Improvements in revenue performance should be sought in the area of tax collection and administration and could also be achieved by broadening the tax base. Moreover, current expenditures would obviously need to be kept under firm control, especially the wages of public sector employees, not only because of the direct effects of those wage increases on the fiscal budget, but also because of the significant effects that those increases could have on private sector wage negotiations. In that respect, it was reassuring to see the indications that government policy would aim at maintaining real wages at a broadly unchanged level.

The authorities should be commended for their management of monetary and exchange rate policy during the past year, Mr. Zecchini considered. Facing a crisis of confidence in the currency and conditions of excess liquidity, they had reacted promptly by placing more emphasis on monetary restraint than on exchange rate changes to ease the pressure on the international reserves. As for the near future, the current tight stance of monetary and exchange rate policy should be maintained in view of the renewed inflationary pressure, the buoyancy of domestic consumption, and the satisfactory export performance. The task of monetary policy had been complicated by the larger debt service burden imposed on the Central Bank by its quasi-fiscal operations in the early 1980s. Although that issue appeared to be a particularly difficult one, the staff's recommendation to the authorities to consider transferring that burden to the Treasury seemed to be appropriate. Such a move would greatly improve the transparency of the public sector's accounts, and it would broaden the Central Bank's freedom to conduct monetary policy.

Many impressive results had been obtained in the implementation of structural reforms, Mr. Zecchini commented. Two structural areas still required further adjustment efforts. First, land reform should be consolidated; in view of that reform's large costs, the availability of adequate financing could be crucial for its success, and financial support from external donors for the land reform would therefore be most valuable. In that connection, the authorities should seek the World Bank's assistance. He was interested to know from the Bank staff representative or from Mr. Rye about the prospects for financial support of the land reform. Second, reforms of the nonfinancial public enterprises should be accelerated, particularly in view of the burden that some of those enterprises placed on the public budget. Reducing the share of public ownership in those corporations and improving their profitability should be the ultimate goals of the reform.

The Philippines was one of the first countries to introduce a debt-equity swap mechanism, which he understood had been used successfully, especially for public sector debt held by the Central Bank, Mr. Zecchini commented. To further improve its scope and to reduce some of the swap's side effects on monetary control, the authorities should consider means of expanding its application to foreign debt held by the private sector.

As was clearly underlined by the staff's medium-term projections, the availability of a sufficient amount of resources would be essential to allow the country to continue to pursue its adjustment efforts, Mr. Zecchini concluded. And although the required amounts were significant, they were not of an unmanageable size. In view of the authorities' successful track record in meeting their commitments and the demonstrated resilience of the economy, the international community should be forthcoming in supporting the country's financial needs. The Fund, in particular, should continue to play a significant role. Since the current stand-by arrangement would expire in August 1988, the authorities should seek further Fund assistance: an extended Fund arrangement seemed to be more appropriate to accommodate the country's adjustment requirements than a stand-by arrangement.

The staff representative from the Asian Department said that only very preliminary estimates of the cost of the land reform program were available, because the reform had been instituted a few days ago. Some reports put the ten-year cost at about $8 billion, part of which would be used for land transfers, while a more substantial sum would have to be used to create the infrastructure needed to support a reformed agricultural sector. The domestic financing of the land reform was foreseen as coming mainly from the sale of nonperforming assets of government financial institutions, from certain sequestered assets, and from sales of public enterprises. The authorities were also looking to foreign donors to finance part of the general improvement in the agricultural sector. With respect to 1988, budgetary provisions had already been made for whatever costs might arise from the implementation of the land reform during the year, so no extra costs would be incurred in the budget. Any financing of the land reform would clearly be a major element in a possible future Fund-supported program, and its fiscal aspects would have to be discussed.

With respect to the nexus between the exchange rate and other macroeconomic policies, the staff had been looking for an appropriate balance between the various macroeconomic instruments, the staff representative continued. For a number of years, the Government had initiated and sustained important structural reforms, while it had also recently tightened monetary policy in response to external and domestic events. A tightening of fiscal policy was essential, and exchange rate policy had an equally important role to play in the adjustment as competitiveness needed to be maintained to make the medium-term scenario a realistic one. While the staff did not believe that in the current situation there was a pressing need for a substantial adjustment, it was concerned about exchange rate policy, because of the inflation differential between the Philippines and its trading partners and the large wage increases that had been granted recently.

It was highly unlikely that fiscal policy would be weakened by transferring the liabilities that the Central Bank incurred when it had acted as a quasi-fiscal agent in the early 1980s, the staff representative emphasized. Mr. Ayales and Mr. Zecchini had pointed out that such transfers, in whatever form, would only make the true fiscal deficit more apparent, and at the same time, would facilitate monetary policy greatly.

In the medium-term projections, the staff had broken down medium- and long-term capital flows above and below the line in the particular format that it had used, the staff representative explained, because it wanted to show above the line the regular flows of project assistance and other aid that could be expected under normal circumstances. Truly exceptional financing was shown below the line, such as further Paris Club rescheduling, or concerted lending from foreign commercial banks. Thus, the staff had drawn a distinction between normal expected flows and exceptional financing.

It was correct that external aid was being disbursed more slowly than it could be, the staff representative remarked, although it should not be forgotten that large commitments had been made since 1986. During the political turmoil, few new commitments had been made; for instance, the World Bank's new commitments and its lending program had slowed during that period, but after the change of government, its commitments had increased. Even though disbursements obviously lagged behind commitments, measures still had to be taken to improve the use of external aid; some measures, such as the Project Facilitation Committee, had been taken with the World Bank's help. The most important bilateral sources of aid were Japan and the United States, and of multilateral aid, the World Bank and the Asian Development Bank.

The shortfalls in public investment had, to some extent, been related to political events, the staff representative added. Moreover, the directorships of many public enterprises had changed, and there had been a most welcome reorientation of the public investment program, which had been judged to have been highly wasteful in the early 1980s. The Government's scrutiny of investments to ensure that they were efficient was worthwhile, but clearly implied that there would be some delays. Nonetheless, the authorities should still take measures to accelerate public investment. Private and public investment were not always substitutes: public investment was needed for the construction of infrastructure and for other projects that the private sector could not be expected to undertake, but which were vital for rapid growth. The need for public sector investment had to be balanced against the medium-term objective of substantially reducing the public sector's deficit and its financial claims in order to allow the private sector to recover fully.

The growth of imports in 1987 had been very rapid, the staff representative agreed, but it should not be forgotten that 1987 was the first year of recovery in which import volume had rebounded from the decline of about 40-50 percent in 1984 and 1985. Import volume growth would henceforth be more stable, or more in line with domestic demand growth, as was reflected in the medium-term import volume projections. Of course, the realization of those projections required the authorities' continued use of appropriate relative price and structural measures.

There was a special government agency called the Presidential Commission on Good Government to recover capital that had fled, or what the authorities called "ill-gotten wealth," the staff representative pointed out. The commission sought to sequester assets in the Philippines and abroad, and the amounts that had been recovered were being used to finance the land reform. Legal action was under way in the Philippines and abroad, but he did not have any further concrete information on those efforts.

It would be difficult to ensure that the debt-equity conversion scheme would result in the provision of additional investment, the staff representative considered. The authorities had adopted a case-by-case approach in which they carefully considered each proposal and then gave their agreement when they felt that it did constitute additional investment.

The debt service ratio had been revised slightly for technical reasons, the staff representative added: some liabilities had been redefined and some price assumptions had been changed. Small changes were made to the debt service ratio projections very frequently.

The staff had only had preliminary discussions with the authorities about a possible future Fund arrangement for the Philippines, the staff representative from the Asian Department concluded. The authorities were considering the matter, and the staff expected to discuss it further with them perhaps toward the end of the summer. Whatever program was adopted, it would have to be cast in a medium-term perspective. In that connection, Directors had mentioned the need for fiscal adjustment and had stressed the need for continued structural reforms in several areas, etc. The staff representative from the Exchange and Trade Relations Department said that, with respect to the status of the authorities' negotiations with the Paris Club, the staff had not yet heard whether the authorities had decided to proceed with a request for further debt rescheduling. The Board might wish to note that the Paris Club agreement covered the period through June 30, meaning that it would have to be extended about two months beyond the expiration date of the stand-by arrangement.

The staff representative from the World Bank said that the Bank was waiting to see the Government's final land reform program before it decided on possible Bank contributions to that effort. Once the Bank staff had seen the Government's proposal, it would be willing to chair a subcommittee meeting of the Consultative Group to bring together external support in line with the program, if the authorities so requested. The Bank was willing, in principle, to support the land reform program, but it had not worked out any definite loans at present. He believed that the estimate for the total cost of the land reform program of $8 billion was probably too high; in any event, the amount the Government would calculate that it would eventually cost was uncertain.

The Chairman asked Mr. Templeman to elaborate on the U.S. Government's intentions with respect to facilitating international support for the Philippines during the next year.

Mr. Templeman said that he could not explain much more than he had already done. An interagency study had been going on within the U.S. Government for some months on the nature and size of the envisaged assistance, and he thought that officials within the Government were getting closer to an agreed position. Some informal contacts with other governments had apparently taken place, but he did not think that those contacts had gone very far. The exercise was certainly intended to be a multilateral one; hence, various governments would, at some point, be asked to participate in it.

With respect to the issue of the funds misappropriated from the Philippines, very complicated cases had been going on for some time in the U.S. court system to restore those funds, Mr. Templeman added. The U.S. legal system was certainly available and was being used by the Philippine Government.

Mr. Salehkhou said that considering the many reports suggesting that the Philippine external debt roughly equalled the amount of capital that might have surreptitiously left the country under the previous government, and given that the Board was spending so much time discussing financial assistance to the country, the staff should give more attention to the sheer magnitude of the capital flight than it had already done. Further analysis and information would benefit other debtor countries, and would be part of the solution to the debt problem. The issue of whether the capital flight should be considered in the context of exchange restrictions or not was a separate one, and he would address it on another occasion.

The Chairman responded that Mr. Salehkhou seemed to place more emphasis on the capital flight than the authorities did: they were using ordinary legal instruments to recover the capital and had not requested that the Fund provide them with any assistance in that respect. The Fund should not interfere in any way with the authorities' efforts, and he did not believe that the Philippines should be used as an example when considering the possible range of application of Article VIII.

Mr. Salehkhou replied that he would consider the uses of Article VIII at a more appropriate time. In any event, the recent news that a Swiss court had ordered the release of nearly $40 million to the Philippines indicated that court proceedings were still continuing, and that the issue of capital flight was still highly relevant. He was not suggesting that the Fund interfere with the authorities' priorities, but believed that it should have a more active interest in capital flight and, at least, give some coverage to the matter in staff reports as part of the solution to the debt crisis.

The Chairman said that the Swiss courts had recognized the validity of the authorities' claims, but the issue remained a problem between the

Philippine Government and one of its nationals and was thus not a matter in which the Fund should interfere. The problem of capital flight was a systemic one, and the Philippines was not an appropriate case for analyzing and for drawing conclusions in that respect. Capital flight was not a problem that was directly under the Fund's jurisdiction because under the Articles of Agreement members were authorized to regulate capital movements; hence, it was a matter for general international law. The staff was therefore correct not to include a special paragraph on capital flight in its report. The Fund would have to spend a great deal of time, and probably would have neither the appropriate staff or the information to deal with the legal issue of capital flight whenever the problems of a developing country were considered.

Mr. Salehkhou said that he differed somewhat with the Chairman on the legal implications of capital flight, but would discuss the issue further on the appropriate occasion.

Mr. Rye said that he had just spoken to the authorities so that he could convey to Directors some concrete information on what would follow the current stand-by arrangement. However, the authorities had not made a decision and were still considering the various options. The requirements of the commercial banks and of the Paris Club would weigh heavily in the final decision, although he agreed very much with Mr. Templeman and Mr. de Groote's view that it was important that the country have a framework of relations with the Fund in which the momentum of adjustment could continue over the medium term. With respect to the Paris Club, there was a precedent for allowing a rescheduling agreement to lapse for some months, and it was almost certain that that would happen again.

The emphasis of Directors on the fiscal area was obviously appropriate, Mr. Rye continued. The budget was the major cause for concern at present, especially given the large rise in current outlays, particularly for personnel. The rise in public sector wages reflected a dual concern of the authorities. On the one hand, they wanted to strengthen the Government's administrative capacity, which was obviously needed owing to the slow disbursement of aid and the slow gearing up of public investment to higher levels. The rise in wages came after a long period of public sector wage restraint during which government remuneration had fallen far behind private sector levels and the morale and status of the public service had deteriorated alarmingly. In that connection, Mr. de Groote's views on the subject were very much in line with the authorities' views. On the other hand, the authorities had wanted to address the country's particular security needs and those in the area of education. The Philippines had a very young population, and it had a tradition of maintaining high educational standards, particularly for such a low-income country. Many problems in the education field had to be dealt with; for instance, teachers' salaries had been abysmally low.

Directors had seen that it was very important to increase public investment, Mr. Rye continued, although they might have exaggerated that need. The trough of public investment in terms of its ratio to GDP was probably reached in 1985 or perhaps in 1986, but that ratio had certainly been increasing since then and would rise further in 1988. The only other thing that he could add with respect to fiscal policy was that the authorities, quite truthfully, accepted that the public sector borrowing requirement and the budget deficit could not continue at their current high levels and had to be reduced.

During the Board's discussion of the proposed extension of the Philippines' stand-by arrangement (EBM/88/34 and EBM/88/35, 3/9/88) there had been an interesting division of opinion on the appropriate roles of monetary and exchange rate policy, Mr. Rye recalled. In view of developments since then, that matter had to be put in stark terms, and he thought that three points could be agreed to by all Directors. First, in fundamental terms, the danger of overrelying on monetary policy could only be avoided by using fiscal policy, through appropriate reductions over time in the budget deficit and the public sector borrowing requirement. Second, the authorities' concern with inflation was legitimate. There was no question of having an objective--at least in the short term--of a zero rate of inflation, as Mr. de Groote had seemed to fear. However, there was certainly a strong desire to keep the inflation rate below the double digit level, partly for psychological reasons and partly for reasons of credibility. The authorities' 8 percent target for the inflation rate had been widely advertised, and they were very keen that they should at least be within striking distance of that target by the end of the year. Of course, monetary policy was the obvious short-term implement to achieve those objectives. Third, the authorities' move, since the previous Board discussion, toward more flexible exchange market policy was appropriate, and a similar degree of flexibility, at least, should be maintained in the future.

The land reform would have no effect on the budget in 1988 since a broad appropriation had already been made, Mr. Rye pointed out. In fact, the costs to the budget in 1988 were likely to be less than the amount appropriated. All Directors seemed to agree that in the longer term, the full implementation of the land reform would require the provision of substantial foreign assistance, although the amount would be less than would have been likely had a more radical reform scheme been implemented, as had seemed possible some time ago. He had no information on the medium-term budget implications of the land reform program, and it was probably too early to speak on that matter.

The Board discussion had left him with several strong impressions of the measures that the authorities would have to adopt or continue if they were to meet their ambitious growth targets, Mr. Rye concluded. Foremost among them was the need for fiscal restraint on current expenditures so that the revival of needed public investment could be pursued in the context of a declining fiscal deficit, on which a great deal of importance had rightly been placed. A measured degree of monetary restraint would have to be continued to prevent a resurgence of inflation, while a flexible exchange rate policy would also have to be maintained or even enhanced, bearing in mind the need for the Philippines to remain competitive, particularly in nontraditional exports. Moreover, the authorities would have to continue along their highly successful path of structural reform, of which the agrarian reform program was seen as being of central importance. He would convey those strong messages to the authorities.

The Chairman made the following summing up:

Directors commended the Philippine authorities for the substantial progress made under the present stand-by arrangement. They noted in particular the strong economic recovery and the successful implementation of a wide range of structural reforms.

Directors noted that the sharp loss in official reserves in late 1987 and early 1988, triggered by political uncertainties, had been arrested, and that the foreign exchange market had stabilized. This had been achieved primarily through a tightening of monetary policy, which had resulted in an increase in interest rates.

A number of Directors expressed concern about the rapid pace and, even more so, the pattern of domestic demand growth; this clearly posed a threat to both price stability and the balance of payments. In this context, Directors welcomed the recent monetary policy action, but emphasized the need for a balanced approach that would perhaps lessen the burden of adjustment on monetary policy and the attendant high real interest rates and make use also of other macroeconomic policy instruments.

In view of the unfavorable inflation differential vis-à-vis both trading partners and competitors and the recent large wage increases, a flexible exchange rate policy designed to maintain competitiveness in tradables--and especially to encourage nontraditional exports--and assist in strengthening both the current and the capital account of the balance of payments would be of critical importance.

In the present situation, and to avoid overreliance on monetary policy, the main concern is fiscal policy. Directors observed that the temporary fiscal stimulus to economic growth envisaged at the outset of the adjustment program had increasingly taken the form of higher current spending rather than the intended strengthening of the public investment program. Most Directors expressed strong concern about this shift in the pattern of public expenditure, and they emphasized the need to reverse it. This would require better control over the growth of public sector wages and other current expenditure. A streamlining of government employment, continued efforts to strengthen revenues--including through a broadening of the tax base--and improvements in tax administration also would be needed to help reduce the public sector's deficit and thus accommodate the financing requirements of a growing private sector in a noninflationary way.

Many Directors alluded to the importance of structural policies. They noted that, in addition to tax reform, the most notable achievements in this area related to the dismantling of sugar and coconut monopolies, the strengthening of the financial system, the initiation of reform of the nonfinancial public sector, including the privatization of many enterprises, and the continuation of trade policy reform. However, Directors also noted with concern that the progress in public sector tariff reform had been slower than envisaged--indeed, that some corrective price adjustments have been rescinded--that tax privileges of some public corporations had been restored, that there was scope for further liberalization of financial markets, and that no firm timetable had been established for removal of the remaining quantitative import restrictions. Directors welcomed the recent adoption of agrarian reform and expressed the hope that this reform program would improve social conditions and alleviate poverty by fostering a more equitable income distribution. Several Directors stressed that the cost of the land transfers should be funded from domestic sources.

On the medium-term prospects for the Philippine economy, Directors observed that continued rapid growth, together with the maintenance of a sustainable balance of payments positions, would be crucially dependent on fiscal adjustment and, in general, on sound financial policies designed to foster domestic savings; continued structural reform; the development of a diversified export base; and the reduction in the import intensity of expenditure. The cost of the agrarian reform also would have to be factored in. The envisaged external financing gaps, after allowing for a gradual replenishment of gross official reserves, would require substantial amounts of exceptional financing involving a combination of further debt rescheduling as well as new money flows. The scope for debt exchanges that would contribute to a reduction in debt should be explored actively, and some Directors noted that direct foreign private investment should also be encouraged. Directors expressed the hope that rapid progress would be made in the discussions between the Philippines and its external creditors on a new financing package. The question was also raised regarding the authorities' intention to seek an extension of their rescheduling agreement with their official creditors. Directors expected that the Fund would continue to play an important role in helping to shape economic policies and in catalyzing external financial support for medium-term adjustment. The close collaboration between the Fund and the World Bank was welcome and would need to continue.

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

2. GUYANA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered a staff paper on the further review of Guyana's overdue financial obligations to the Fund following the declaration of its ineligibility to use the Fund's general resources effective May 15, 1985 (EBS/88/116, 6/13/88). They also had before them a policy framework paper for Guyana (EBD/88/170, 6/20/88).

Mr. Kafka said that the authorities had asked him to say that they deeply regretted that financial difficulties had thus far prevented them from becoming current with the Fund, but that with the help of the World Bank and the Fund, they had come to an agreement on a policy framework paper, and that they were confident that they would soon be able to change their present status and so again become fully current in their obligations to the Fund.

Mr. Grosche said that he was quite disappointed that since the Board's previous review in December 1987, Guyana's arrears had continued to rise in the General Department and to the Trust Fund; it was also frustrating that only $2 million out of the country's estimated $30 million in debt service payments in 1987 had gone to the Fund. Guyana's failure to settle its arrears placed a heavy financial burden on other members and violated the cooperative spirit of the Fund. The authorities should do everything possible to discharge their financial obligations to the Fund as early as possible.

Unlike the previous reviews, however, the current one seemed to offer some hope that the authorities would take appropriate action, which he hoped would become more real during the coming months, Mr. Grosche continued. In any event, the fact that a policy framework paper had been formulated and that the authorities obviously intended to adopt a comprehensive program of macroeconomic and structural adjustment was welcome, as was the fact that the paper had been circulated that morning. However, in view of Guyana's record, he wanted to see prior actions taken before he formed an opinion on whether the time had come for the international community to make increased external financial assistance available to Guyana. Meanwhile, he supported the draft decision.

Mr. Enoch said that the news that discussions on a policy framework paper for Guyana had been concluded was welcome. The economy had deteriorated rapidly during the previous few years, and a drastic and far-reaching program would be necessary to bring it back to viability--even over the medium term. He hoped that the policy framework that had been agreed to would be sufficient to meet that challenge and that the authorities would have the strength to implement policies that would no doubt encounter some fairly strong political opposition.

A major complicating factor in the adjustment was the large amount of finance that would be needed to clear arrears to international financial institutions before a structural adjustment or enhanced structural adjustment arrangement could be approved, Mr. Enoch continued. The figures involved were quite daunting, particularly when compared with the size of the economy, and making the necessary financing arrangements was bound to take some time. However, it would be necessary to secure the financing and to eliminate the overdue obligations before a structural adjustment or enhanced structural adjustment arrangement could be approved, which might delay the process considerably. He would welcome any clarification by the staff on the likely timetable of events.

He agreed fully with the regret expressed by Mr. Grosche that Guyana's arrears had continued to increase, although he understood that Guyana still made debt service repayments to some creditors and, in fact, remained current on its debts to the Inter-American Development Bank and to the International Development Association, Mr. Enoch concluded. The authorities had to be reminded that the nature of the Fund's resources was such that Fund repurchases and charges should be granted absolute priority over other external obligations, and the authorities should act accordingly.

Mr. Noriega said that during the past year, the authorities had been shifting the stance of their economic policies with the dual purpose of achieving stabilization--by correcting the fiscal and external imbalances--and of liberalizing and decentralizing economic decision making. That movement was still only an incipient one, although it had begun to bear some modest results. The overall deficit of the nonfinancial public sector had been curtailed, while the accounts of public enterprises had turned into a substantial surplus; the inflation rate, which was expected to reach about 50 percent in 1987, did not exceed 30 percent; and the external deficit fell by approximately 20 percent. However, it should be noted that those positive results were also made possible by an improvement in the terms of trade and that notwithstanding that improvement, arrears had continued to mount, and the economy had not expanded as expected.

The Government was very conscious of the mounting arrears, Mr. Noriega continued, and intended to proceed with the adjustment by implementing a comprehensive medium-term program that should enable Guyana to normalize its relations with the international financial community and with the Fund. He fully supported the authorities' intentions and urged management to continue to collaborate actively with them, but considered the pace of the authorities' actions insufficient to rally the internal and external support necessary to launch a comprehensive program. The economic and financial policy framework paper that had been produced jointly by the authorities, the World Bank, and the Fund should be an opportunity for the authorities to implement promptly the domestic measures needed to attract fresh foreign financing. He supported the proposed decision, but thought that paragraph 3 could point out explicitly that the adoption of the policy framework paper was a positive step by the authorities.

The Chairman wondered whether Mr. Noriega considered that the adoption of the policy framework paper was a positive step by the authorities only, or by the Fund also.

Mr. Noriega responded that as he had stated, the policy framework paper had been produced jointly by the authorities and the Fund, and he thought that it was a positive step in their relationship.

The Chairman said that he was hesitant to have the adoption of the policy framework paper described as a positive step by the authorities only, and that he sometimes wondered whether the Fund was overly generous in using its staff time and resources to negotiate policy framework papers with countries that were in arrears to the Fund, although there were obviously very good reasons for doing so. Credit should also be given to the Fund, because the time could come when mounting arrears would prevent the Fund from negotiating policy framework papers with countries.

Mr. Noriega said that he did not want to minimize the role of the Fund in any way; in urging management to continue an active collaboration, he had in mind highlighting that the situation was different from what it had been six months before, at the time of the previous review.

Mr. Donoso said that the situation in Guyana remained very difficult: although the current account deficit had declined slightly in 1987, negative capital flows had increased the overall balance of payments deficit. The Government's efforts to adopt and refine a comprehensive adjustment program and its intention to maintain the program until 1991 were gratifying. The authorities should promptly implement the program and thus open the way for the country to become current with the Fund, while, on its part, the Fund should adopt a supportive attitude to speed the whole process of recovery and the elimination of the arrears. The authorities had made very small payments to the Fund; but, nonetheless, those payments were significant in that they indicated the importance that the authorities attached to normalizing their relations with the Fund.

Ms. Gold welcomed the recent discussions between the authorities and the staff on a policy framework paper and looked forward to the time when the paper could be reviewed. Those discussions were evidence that Guyana wished to regularize its relations with the Fund and other creditors. She hoped that the understanding reached on the policy framework paper would provide a firm basis for the authorities to embark on a much delayed medium-term adjustment program.

Nevertheless, it was regrettable that Guyana had been unable to settle its obligations to the Fund and that it had only made a small payment since the previous review, Ms. Gold continued. She had particularly hoped that Guyana could have made a more significant payment to the Trust Fund as evidence of a strong commitment to normalize its relations with the Fund.

With respect to the policy framework paper, it was clear that to implement a comprehensive adjustment program, Guyana would require substantial concessional financing over the next several years, Ms. Gold observed. To obtain such support, she agreed with Mr. Grosche that the authorities would need to establish a firm track record to show their strong commitment to reform. Early implementation of some of the adjustment measures discussed in the policy framework paper would go a long way toward establishing such a track record and would greatly facilitate the task of obtaining the required financing. Despite the fact that external financing would be required to implement all of the reforms, considerable progress could be achieved without having all of the financing in place. Some policy reforms had been implemented during the recent past, particularly the substantial adjustment of the exchange rate; however, in light of the large financial support expected from donors, the authorities should not delay undertaking further reforms of equivalent importance.

Canada had indicated at the recent meetings of the Caribbean Group for Cooperation and Economic Development (CGCED) that it would make every effort to provide support for the authorities in their efforts to obtain financing, Ms. Gold concluded. When a Fund-supported program was implemented, Canada intended to increase its bilateral assistance by a considerable amount. She understood that other donors had made similar commitments, but stressed that the first step lay with the authorities and their willingness to begin the process of adjustment. She supported the decision and Mr. Noriega's proposed amendment.

Mrs. Walker made the following statement:

> The agreement reached on the policy framework paper is genuinely welcome, as is the fact that the paper was distributed this morning. The agreement is, of course, just one step in the process of resolving Guyana's overdues problem, but it is an important one because it shows the authorities' willingness to move ahead in resolving the issue.
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> I had the same idea as Mr. Noriega of changing the decision in some way to acknowledge the policy framework paper process more directly than in the current decision. His point might be captured if paragraph 3 of the decision were to read: "The Fund welcomes the authorities' cooperation with the Fund and the World Bank in formulating the framework for a comprehensive program of macroeconomic and structural adjustment and urges the authorities to begin implementation of this program as a matter of urgency." In that way, some reference would be made to the policy framework process, and the point relating to the urgency of the need to take the reforms would be strengthened.
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> In Guyana's case, the financing arrangements to support a program will be complicated owing to the size of the external financing needed to support the kind of comprehensive program that is included in this policy framework. The authorities'

reluctance to launch a reform process of this magnitude before the financing arrangements have been outlined is partly understandable, but I agree with other Directors that it is critical that the authorities move ahead with some of the reforms to generate the financial assistance that will be required. Therefore, the authorities should begin as soon as possible to implement some of the reforms in the program that do not necessarily have adverse short-term financial consequences. While I was only able to glance briefly at the policy framework paper this morning, I saw some areas in which action could perhaps be started in the short term: some further liberalization of the no-funds import licensing scheme; some further progress in public sector enterprise reform; some movement on interest rate policy; and wage containment. This is not meant to be an exhaustive list, but an indication of areas in which the authorities might be able to move ahead prior to receiving full financing assurances.

In addition, Guyana may be a case in which it would be useful to establish a working group in the Executive Board, as we have discussed in some of the other cases. While also recognizing that the World Bank will be taking the lead in the Consultative Group in this case, there still seems to be a role for the Executive Board in terms of developing ideas on bridge financing, a function that should be led by one of Guyana's donors.

It is a cause for concern that Guyana has made such small payments to the Fund since the previous review. Information on which creditors received the $30 million in debt service payments in 1987 would be appreciated.

Considering that Guyana is current with the Inter-American Development Bank, it might be appropriate, along the lines of the decision on Zambia, to amend paragraph 2 to include the following sentence: "in this context the Fund notes that Guyana has made substantial payments to other creditors, and therefore does not appear to be treating the Fund as a preferred creditor."

Alternatively, the Chairman's letter to the authorities could mention that the Board had noted that Guyana had made payments to other creditors, but as of yet, had only made very small payments to the Fund. There are two parts to resolving an arrears problem: one part that is certainly very important is the adoption of a comprehensive adjustment program; but another part is making payments, when possible, to the creditor. This point should be reflected in either the decision, or in the Chairman's letter.

Perhaps a three-month review period would have been better than a four-month one to keep the process moving and to follow

Fund practice in similar cases. I do recognize, however, that there is some logic in having a four-month period, so I will not press the point.

Mr. Rye said that he wished to associate himself with earlier speakers' remarks, particularly those of Mr. Grosche and Mr. Enoch. Guyana had made only a fairly token payment of $0.5 million to the Fund since the previous review in December 1987, and he wondered whether the staff had any information on the size of that payment in relation to Guyana's debt service payments to other creditors during the period, or, in other words, whether the authorities were still giving Fund repurchases a very low priority, as they had done in 1987. He supported the proposed decision and would not object to the addition of a neutral form of wording on the policy framework paper.

Mr. Adachi said that he was pleased to learn about the recent developments in Guyana. After the economy had begun to deteriorate six years ago, the authorities had implemented a number of piecemeal measures that had not been of much help. Therefore, the completion of the policy framework paper was particularly welcome, and he assumed that the areas that the staff believed required real policy changes were covered in the paper. He wished to stress that when the Board considered Guyana's performance record it should look for more than commitments only: prompt action was needed, namely, the implementation of far-reaching comprehensive measures, which would certainly assist in mobilizing the sought-after support from the international community. He would welcome the staff's comments on the schedule for setting up the program's financing scenario. He supported the decision and Mrs. Walker's proposed amendments.

Mr. Al-Assaf said that Guyana's continuing failure to meet its financial obligations to the Fund was regrettable, and he again reminded the authorities of the burden that those arrears were placing on other members. At the same time, the authorities' implementation of some positive policy measures and their intention to implement a more comprehensive adjustment program were welcome. He agreed with Mrs. Walker's amendment to paragraph 3 of the decision and with her suggestion of mentioning, in one way or another, the discriminatory nature of Guyana's debt service payments either in the Managing Director's letter to the authorities or in the decision itself. In addition, it would be helpful if the staff, in future reviews of overdue obligations, gave a detailed breakdown of a country's debt service payments to all creditors, instead of having Directors search for that information.

Mr. Fogelholm said that he agreed with other Directors that recent developments had been disappointing, but that it was truly encouraging that the situation might be turning around and that a comprehensive program had been worked out. The real cause for concern was that in its pattern of debt service payments, Guyana had not treated the Fund appropriately;

he wished to hear from the staff about the amounts that other creditors had been paid during the previous year. He supported Mrs. Walker's proposed amendment with respect to the authorities' pattern of debt service payments.

Mr. Chatah said that he supported the proposed decision and the amendment recognizing the policy framework paper. With respect to the amendment on Guyana's payments to the Fund, he wished to wait and hear what the staff had to say about the distribution of payments in 1987 to various creditors. Like Mr. Enoch, he had noted the table on page 29 of the policy framework paper on Guyana's outstanding external public debt to the Inter-American Development Bank, the International Development Association, and other creditors.

Mr. Salehkhou said that he supported the decision and Mr. Noriega's proposed amendment, which he believed would encourage the authorities to accelerate the process of adjustment and hopefully to become current with the Fund. Like others, he noted Guyana's discriminatory pattern of debt service payments, and wished to know from the staff what the Fund's policy was with respect to such a pattern.

The staff representative from the Western Hemisphere Department said that out of Guyana's total debt service payments in 1987, $6.8 million had been paid to governments, the bulk of which went to the German Democratic Republic and to the U.S.S.R. Excluding the Fund, payment of $8 million had been made to multilateral agencies, $7 million of which went to the Inter-American Development Bank, which was active in Guyana, disbursing an estimated $12 million to that country in 1987. Interest payments to banks of about $4.3 million had been made, plus about $1.8 million in payments to suppliers, and $5.2 million in payments for what were known as nationalization loans, or payments for the nationalization of the bauxite and sugar industries. The foregoing list of payments totaled about $26 million, to which should be added the $2 million paid to the Fund, and the payment of about $1 million made to Venezuela on a short-term facility for oil imports that had been established two years previously. With those two additions, the debt service payments totalled $29.1 million; the remaining amount of about $0.9 million was not something he had detailed information on. The incomplete information that was available on the debt service payments made through March 1988 indicated that Guyana had continued to make payments to commercial banks, the Inter-American Development Bank, and had made some very small payments to the International Development Association. That profile of debt service payments had been maintained during the previous two years.

Once the policy framework paper had been reviewed by the Committee of the Whole of the World Bank and the Fund Board, the authorities intended to approach both traditional and nontraditional sources of financing with a view to obtaining financial commitments for the program, and particularly for the bridge financing that would be required to clear the arrears to the Fund, the World Bank, and other multilateral institutions, the staff representative continued. The authorities intended to start the process around July 20, and in the context of those efforts--which would likely continue through the remainder of July and August--to call, in collaboration with the World Bank, for a special subgroup meeting of the Caribbean Consultative Group for the early fall. He understood that the subgroup meeting would be held if the discussions with possible financing sources indicated that some commitments were likely to emerge. If not, the authorities would probably continue their contacts with the financing sources. The program that was outlined in the policy framework paper was framed as if it would start on October 1, taking into account the foregoing schedule.

The staff representative from the Legal Department said that there had been six previous cases in which the Board had considered countries that were overdue in their financial obligations to the Fund at the same time that the policy framework paper was circulating. In those cases, no reference had been made in the decisions to the policy framework paper, because a formal decision by the Fund in dealing with a policy framework paper was made at the conclusion of the consideration of the paper itself; the current meeting was not intended to consider Guyana's policy framework paper, which had only been circulated to the Board on June 20. Therefore, if a reference was to be made in the current decision to the policy framework paper, the wording would have to be qualified to indicate that the policy framework paper would be considered by the Board later.

Mrs. Walker wondered whether her proposed wording that, "the Fund welcomes the authorities' cooperation with the Fund and the World Bank in formulating the framework for a comprehensive program...," which had purposely not mentioned the policy framework, was appropriate.

The staff representative from the Legal Department said that he thought that Mrs. Walker's wording did recognize the Board's collaboration in preparing the policy framework paper and that the policy framework paper would be considered later. Of course, the Board could, if it wished, change its practice of only referring to a policy framework paper in a decision when the particular paper was considered.

The Chairman said that he had no difficulties with the suggestion that the negotiation of the policy framework paper be mentioned in a neutral manner. He wished to make two points in his letter to the authorities, namely, that the agreement on the policy framework was a positive joint step by the authorities and the Fund, and that the authorities had treated the Fund inappropriately by giving priority to other creditors in making debt service payments. Better treatment of the Fund by the authorities was necessary, especially as the Fund was negotiating with them to re-establish the basis for cooperation. Among the possible signals of the authorities' good intentions toward the Fund, it was essential that they become current with the Fund on new obligations that fell due as soon as possible.

It was a helpful idea to establish an informal task force or working group on Guyana in the Board to monitor developments in the policy framework negotiations and the special Consultative Group's efforts to marshall international support for Guyana, the Chairman continued. Appropriate steps would be taken to establish that informal working group, and he especially welcomed Canada's intentions to help Guyana at the current difficult juncture. In addition, although he might have preferred a three-month period until the next review took place, a four-month period was best because it would not coincide with the Annual Meeting.

Mr. Kafka said that he was pleased by some Directors' recognition that Guyana would first have to adopt necessary adjustment measures--which it, in fact, wished to do at the earliest opportunity--before it could gain access to more foreign financing. The decision need not be amended, because the Chairman's agreement with Mrs. Walker's suggestion to include some of the proposed changes in his letter to the authorities was sufficient to meet all of the purposes that Directors had in mind.

Mrs. Walker said that the reason why she had wished to delete the words "take the necessary actions to" in paragraph 3, and leave the words "urges the authorities to begin implementation of this program" was that she did not believe that the former phrase was necessary and because the sense of the meeting seemed to have been that movement on policy should be generated as quickly as possible in Guyana. The deletion would strengthen the sentence.

Mr. Kafka said that he thought that Mrs. Walker's proposed deletion would not have a substantive effect. Therefore, he urged that the original wording be retained.

Mrs. Walker said she could accept the original wording on that basis.

The Executive Board then took the following decision:

1. The Fund has reviewed further the matter of Guyana's continuing failure to fulfill its financial obligations to the Fund in light of the facts and developments described in EBS/88/116 (6/13/88).

2. The Fund deeply regrets the continuing failure by Guyana to settle its arrears to the Fund, which are placing a financial burden upon members and reducing Fund resources needed to help others. The Fund notes that only modest payments have been received from Guyana since 1985. The Fund again urges Guyana to make prompt and full settlement of its overdue obligations to the Fund and stresses that settlement of these arrears should be given the highest priority.

3. The Fund welcomes the authorities' intention to adopt a comprehensive program of macroeconomic and structural adjustment and urges the authorities to take the necessary actions to begin implementation of this program as a matter of urgency. The Fund hopes that the adjustment efforts on the part of Guyana will encourage a timely and constructive response from Guyana's

donors and creditors, and all other countries that can help Guyana, to the authorities' request for expanded external financial assistance.

4. The Fund will be discussing its general policies on arrears shortly. It will review the position of Guyana within four months from the date of this decision in light of its discussion of general policies on arrears and of actions taken by Guyana in the meantime to settle its arrears, and begin implementing a comprehensive adjustment program.

Decision No. 8909-(88/97), adopted
June 20, 1988

APPROVED: January 25, 1989

JOSEPH W. LANG, JR.
Acting Secretary