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EBS/87/65

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March 23, 1987

To: Members of the Executive Board

From: The Acting Secretary

Subject: Philippines - First Review Under the Stand-By Arrangement and Request for Modification

Attached for consideration by the Executive Directors is the staff report for the first review under the stand-by arrangement for the Philippines and its request for a modification, which is tentatively scheduled for discussion by the Executive Board on Monday, April 20, 1987. A draft decision appears on pages 44 and 45.

Mr. Singh (ext. 7321) or Mr. Goldsbrough (ext. 4735) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

PHILIPPINES

Staff Report for the First Review of the Stand-By Arrangement and Request for a Modification under the Stand-By Arrangement

Prepared by the Asian and Exchange and Trade Relations Departments

(In consultation with the Fiscal, Legal, and Treasurer's Departments)

Approved by P.R. Narvekar and Eduard Brau

March 23, 1987

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Annexes

I. Introduction 1/

Discussions with the Philippine authorities for the first review under the stand-by arrangement were held in Manila during February 16-27, 1987. 2/ The Philippine representatives in these discussions included Minister of Finance Jaime Ongpin, Central Bank Governor Fernandez, and Minister of Economic Planning Solita Monsod, as well as other senior officials from the Office of Budget and Management, the Department of Trade and Industry, and key government corporations and financial institutions.

The Philippine authorities have formulated an economic program for 1987 3/ and policies have been quantified in proposed performance criteria through December 1987. The authorities have requested a waiver of the nonobservance of the performance criterion pertaining to the December 1986 ceiling on base money and have also requested modifications to the March 1987 performance criteria with respect to base money and the public sector borrowing requirement (PSBR). These requests as well as a description of the economic program for 1987 are contained in a letter from the Minister of Finance and the Governor of the Central Bank, dated March 10, 1987 that has been circulated to Executive Directors (EBS/87/59, 3/12/87).

The Executive Board approved an 18-month stand-by arrangement for the Philippines on October 24, 1986 (EBS/86/222, 9/22/86 and Supplement 1, 10/17/86), in an amount equivalent to SDR 198 million (45 percent of quota and equivalent on an annual basis to 30 percent of quota). At the same time, the Board also approved a purchase equivalent to SDR 224.1 million (50.9 percent of quota) under the compensatory financing decision. The Philippines has made two purchases thus far under the stand-by arrangement: the equivalent of SDR 5 million following Board approval of the arrangement and a second purchase of the equivalent of SDR 18 million linked to compliance with end-October 1986 performance criteria. 4/ A third purchase, equivalent to

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1/ It should be noted that the term "country" used in this report does not in all cases refer to a territorial entity that is a state as understood by international law and practice. The term also covers some territorial entities that are not states but for which statistical data are maintained and provided internationally on a separate and independent basis.

2/ The staff team comprised Anoop Singh (head), Cha, Goldsbrough, and Gurgen (all ASD), Lipton (ETR), Catsambas (FAD), and Hatcher (secretary, BCS). The staff team was assisted by Mr. Karlik, the Resident Representative. Mr. Rye, Executive Director, attended some of the discussions.

3/ Quantitative performance criteria through March 31, 1987 had been established at the time of approval of the arrangement.

4/ EBS/87/12, 1/22/87.

SDR 35 million, which was scheduled to be made on or after February 1, 1987, based on compliance with end-December 1986 performance criteria, has not been made because the December ceiling on base money was exceeded. The fourth purchase, also equivalent to SDR 35 million, scheduled to take place on or after May 1, 1987, is conditional on completion of the first program review, as well as on the observance of March 1987 ceilings.

A modification of the March ceilings on base money and PSBR has been requested by the authorities as well as a waiver of the nonobservance of the end-December ceiling on base money, which was exceeded. It is proposed in the draft decision presented in Section VIII, that the Executive Board approve the requested modification, and that the Philippines be permitted to make a purchase equivalent to SDR 35 million upon completion of the review on the strength of the understandings that have been reached and that the performance criteria set forth in the proposed decision apply to subsequent purchases under the arrangement. 1/

As of February 28, 1987, the Philippines' outstanding use of Fund credit stood at 214 percent of the Philippines' quota of SDR 440.4 million, including the equivalent of 72 percent of quota under the compensatory financing facility. Because scheduled repurchases exceed purchases during the remaining period of the stand-by arrangement, total Fund credit outstanding to the Philippines would decline to 195 percent of quota at the end of the arrangement (Table 1). Information on the Philippines' relations with the Fund is provided in Annex I.

II. Background

1. The aftermath to the economic and financial crisis of late 1983

The period from October 1983, when the Philippine authorities requested a standstill on maturing principal payments on most external debt, until mid-1986 was characterized by a substantial decline in output and an even sharper fall in domestic absorption. 2/ The extent

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1/ Because the purchase equivalent to SDR 35 million upon completion of the review will be made after March 31, 1987 (instead of during the first quarter of 1987 as originally contemplated), no waiver for the nonobservance of the December 31, 1986 performance criterion on base money is in order.

2/ More detailed reviews of the background to the October 1983 crisis and its aftermath are contained in the report on the 1986 Article IV consultation and the request for stand-by arrangement (EBS/86/222, 9/22/86) and in the report on the request for the previous stand-by arrangement (EBS/84/226, 11/5/84).

Table 1. Philippines: Fund Position During
Remaining Period of Arrangement, 1986-88

	Outstanding at Dec. 31, 1986	1987 Jan.-Mar.	1987 Apr.-June	1987 July-Sept.	1987 Oct.-Dec.	1988 Jan.-Mar. 1/
		(In millions of SDRs)				
Transactions under tranche policies (net)	...	12.1	24.2	1.8	-1.8	4.7
Purchases	...	18.0	70.0	35.0	35.0	35.0
Ordinary resources	...	(6.0)	(23.3)	(11.7)	(11.7)	(11.7)
Borrowed resources	...	(12.0)	(46.7)	(23.3)	(23.3)	(23.3)
Repurchases	...	-30.1	-45.8	-33.2	-36.8	-30.3
Ordinary resources	...	(-12.5)	(-24.9)	(-12.5)	(-18.3)	(-17.8)
Borrowed resources	...	(-17.6)	(-20.9)	(-20.7)	(-18.4)	(-12.5)
Transactions under special facilities (net) 2/	...	-23.6	-23.6	-23.6	-23.6	-23.6
Purchases	...	--	--	--	--	--
Repurchases	...	-23.6	-23.6	-23.6	-23.6	-23.6
Total Fund credit outstanding (end of period)	958.8	923.1	923.8	902.0	876.7	857.8
Under tranche policies	616.9	604.8	629.0	630.8	629.0	633.7
Special facilities 2/	341.9	318.4	294.8	271.2	247.7	224.1
		(As percent of quota)				
Total Fund credit outstanding (end of period)	217.7	209.6	209.8	204.8	199.1	194.8
Under tranche policies	140.1	137.3	142.8	143.2	142.8	143.9
Special facilities 2/	77.6	72.3	66.9	61.6	56.2	50.9

Source: Staff estimates.

1/ Although the stand-by arrangement would run through mid-April 1988, data on the Fund position are presented through March 1988.
2/ Compensatory Financing Facility.

of these declines reflected, inter alia, the degree of internal and external imbalances prior to the onset of the crisis, the severity of the foreign exchange constraint which forced a rapid external adjustment, and delays in tackling longstanding structural weaknesses. Real GNP fell by a cumulative 10 percent during 1984-85 and the external current account, which had reached a deficit of over 8 percent of GNP in 1983, shifted into a substantial surplus by 1986. Most of the decline in absorption was borne by investment, which fell from an unsustainable 27 percent of GNP in 1983 to only 14 percent in 1986.

The gains in stabilization achieved until end-1985 were threatened in early 1986 when the financial environment deteriorated as a result of events associated with the Presidential election. Fiscal policy turned sharply expansionary; currency demand rose considerably as a result of the unsettled conditions and political boycotts of certain banks; and interest rates increased dramatically. The official exchange rate depreciated significantly and a black market in foreign exchange re-emerged temporarily. The third review under the 1985-86 stand-by arrangement was not completed, and the new Government requested a new arrangement with the Fund.

2. Performance under the present stand-by arrangement

The authorities' economic strategy was to lay the foundations for renewed economic growth through wide-ranging structural reforms designed to reduce government intervention in economic decision-making, reestablish competitive markets, and promote a more outward-looking economy. Meanwhile, a limited fiscal stimulus, through a substantial resurgence of depressed public investment and maintenance expenditures, was intended to spark an economic recovery in the second half of 1986. This stimulus was then to be withdrawn, as reforms of the tax system and public corporations reduced the public sector deficit, so as to release resources for the private sector recovery.

In the event, the restoration in public investment and maintenance expenditures was slower than programmed, so that the anticipated fiscal stimulus was below the targeted level. Moreover, although many of the reforms aimed at improving the business environment were implemented as anticipated, prolonged political uncertainties further stalled the response of business confidence. Consequently, the economic recovery in the second half of 1986, with GNP growth of 2 percent over the second half of 1985, was well below the 6 percent growth provided for in the program. Continued growth in agriculture and a moderate recovery in manufacturing and services were the major sources of the output gains in this period. There was also a rebuilding of inventories in the latter part of the year, reversing several years of decline. However, private construction activity remained depressed, with a major contributory factor being the virtual suspension of housing finance while lending programs and agencies were consolidated and restructured. Inflation declined more sharply than targeted; by end-year, the 12-month inflation rate was zero (Table 2).

a. Public finances

Both the monitored and the consolidated public sector deficits were held to levels considerably below the 1986 program. 1/ Within the monitored group, although the deficit of the National Government, at ₱ 28.1 billion (4.7 percent of GNP) was broadly on target (4.4 percent of GNP), it reflected shortfalls in both revenues and expenditures. The revenue shortfall, equivalent to over 1 percent of GNP, reflected delays in implementing elements of the tax reform package as well as revisions to the yield of the package, especially for cigarette excise taxes (Annex II), and, in lesser part, the slower economic recovery and the associated lower growth in imports. The planned restoration of investment and maintenance expenditures, essential to redress longstanding needs as well as to initiate a broader recovery, was also delayed (with shortfalls of 17 percent and 30 percent respectively compared with the program targets) because the process of developing a new political consensus on expenditure priorities and installing new expenditure control procedures took longer than expected.

Similar delays contributed to substantial shortfalls in capital expenditures by the 14 monitored nonfinancial corporations, and especially by the power and water utilities. Consequently, the combined deficit of the corporations was well below the program target. As a result, the monitored PSBR was substantially lower than originally programmed (equivalent to 4.2 percent of GNP as against a program target of 5.5 percent).

The deficits of the GFIs and the Central Bank were also lower than projected in 1986, reflecting primarily the stronger-than-anticipated decline in domestic and foreign interest rates. In all, the broadest measure of the consolidated public sector deficit was under 6 percent of GNP, compared with a program target of 7.5 percent.

b. Monetary developments

Broad money (M3) growth during 1986, at 13 percent, was similar to that projected in the program but there was a larger-than-anticipated decline in velocity (Chart 2 in Section III.5). The program targets for

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1/ The consolidated public sector includes the National Government and the 14 major nonfinancial corporations (a subgroup called the monitored public sector), whose borrowing requirement is subject to performance criteria, as well as the important Government Financial Institutions (GFIs), the Central Bank, and other nonfinancial public corporations, local governments, and the social security system.

Table 2. Philippines: The Adjustment Program, Performance and Principal Objectives, 1984-88

	1984	1985	1986 Program	1986 Actual	1987 Original program	1987 Revised program	1988 Indicative 1/
GNP and prices (percentage changes)							
Real GNP	-6.8	-3.8	1.5	0.1	6-7	6.5	6.5
Consumer price index (end-period)	50.8	5.7	5	-0.3	5-6	5.0	5.0
Consumer price index (average)	50.3	23.1	4	0.8	5-6	5.0	5.0
External objectives							
Current account surplus/deficit (-) ($ bn.)	-1.3	--	0.3	1.0	-0.4	0.2	-0.6
(Percent of GNP)	(-4.0)	(--)	(0.9)	(3.3)	(-1.2)	(0.7)	(-1.7)
Exports (percent change in $ value)	7.7	-14.1	-0.6	3.3	0.1	10.4	8.7
Imports (percent change in $ value)	-18.9	-15.8	0.8	-4.1	12.2	22.4	14.2
Trade balance ($ bn.)	-0.7	-0.5	-0.6	-0.1	-0.8	-0.7	-1.1
Net international reserves (banking system) (change in $ bn.)	0.2	-2.8	-1.2	-1.2	-0.8	-1.2	-1.6
Gross official reserves ($ bn.)	0.9	1.1	2.4	2.5	2.7	3.4	3.4
(months of imports of goods and services) 2/	(1.3)	(1.6)	(3.1)	(3.1)	(3.2)	(3.8)	(3.6)
Arrears ($ bn., end-period)	2.7	--	--	--	--	--	--
Debt service ratio (after rescheduling)	35	33	36	33	35	31	30
External debt ($ bn., end of period)	25.4	26.3	26.8	28.2 3/	27.2	28.9	29.5
(Percent of GNP)	(80.6)	(82.2)	(86.0)	(95.1)	(81.0)	(89.1)	(82.0)
				(In percent of GNP)			
Savings and investment							
Gross domestic investment	19.2	16.2	17-18	14.0	20-21	17.4	20.0
Gross national savings	15.2	16.2	18-19	17.3	19-20	18.1	18.3
Foreign savings	4.0	--	-0.9	-3.3	1.2	-0.7	1.7
Public sector							
National government deficit	1.9	1.9	4.4	4.7	2.4	3.1	2.0
Monitored public sector borrowing requirement (PSBR) 4/	3.0	2.6	5.5	4.2	2.9	3.5	2.6
Consolidated public sector deficit	8.3	6.1	7.5	5.9	5.2	5.4	5.1
Public investment	4.5	3.5	5.0	3.8	5.0	5.0	5.0
Average National Government compensation per employee (percentage increase)	20.3	34.4	8.0	7.9	...	23.6 5/	...
				(Percentage increase)			
Money (end period)							
M3	7	10	13	13	15	15	15
Monetary base (base money) 6/	12	8	15 7/	21 7/	16 7/	14 7/	16
Interest rate (percent per annum) 8/	36.3	12.6	11.0	8.1	...	7-8	...

Sources: Data provided by the Philippine authorities; and staff estimates.

1/ Essentially the same as in the original program; export and import growth is raised slightly.
2/ Differs slightly from figures in EBS/86/222 since gross reserves in this table are expressed in terms of following rather than current year's imports of goods and services.
3/ End-1986 stock of external debt is valued at exchange rates prevailing on that date and reflects a revaluation increase of $1.4 billion.
4/ The monitored public sector consists of the National Government plus the monitored nonfinancial corporations.
5/ Exclusive of a one-time payment, the average increase is 18 percent.
6/ Monetary base is defined as reserve money plus reserve eligible securities plus reserve deficiencies.
7/ Growth rates calculated using the averages of the 10-day test periods.
8/ 90-day money market rate; average of the last week of the period.

base money assumed a decline in the (seasonally-adjusted) currency-deposit ratio from their peak of early 1986. In the event, a shift from deposit to currency holdings occurred in the last half of 1986 and continued in early 1987, owing to the reduced opportunity cost of holding currency and to the renewed political uncertainties. This was the principal factor that led to the base money ceiling at end-December 1986 being exceeded. Reflecting the shift in currency demand, base money grew at a rate of 21 percent in 1986 compared with a program target of 15 percent. 1/

Interest rates declined more rapidly than projected during the second half of 1986, but remained high in real terms. By end-year, the rate on 90-day money market deposits was about 8 percent and the lending rate for prime borrowers was 12.5 percent, half the peak levels of March 1986.

c. External developments and financing arrangements

The substantial turnaround in the balance of payments, which began in 1984-85, continued in 1986. From near balance in 1985 the current account shifted to a significantly larger-than-projected surplus in 1986 ($1.0 billion or 3.3 percent of GNP). The principal contributory factors were continued strong growth in receipts from services, especially from travel, and a lower-than-projected level of imports associated with the slower economic recovery. Export performance was broadly as targeted in the program, although earnings from traditional commodities remained weak. Among the newly emerging nontraditional group, the continued stagnation in electronics exports was more than offset by the success of other commodities, particularly garments, in further penetrating existing markets and tapping new ones.

The capital account (before rescheduling and other exceptional financing) recorded a larger-than-projected net deficit, of about $1.4 billion. The slower pace of implementation of externally-financed investment projects contributed to a shortfall in medium- and long-term capital inflows and, in addition, there occured a significant outflow of short-term capital reflecting an increase in export financing as well as a decline in the outstanding value of oil-related trade credits. In sum, the overall balance of payments deficit, at under $400 million, was less than programmed. This was financed by previously agreed rescheduling of Paris Club debt (through June 30, 1986) and commercial bank debt together with the disbursement of the remaining amount of the 1985 new money package from commercial banks, which also permitted a build-up of gross reserves by year-end to about 3 months of projected 1987 imports of goods and services.

1/ These growth rates are calculated on the basis of the 10-day test periods.

External debt, revalued to reflect exchange rate changes, amounted to $28.2 billion at end-1986, with only $5.4 billion in the short-term category (Table 3). The rescheduling arrangements since 1983 have helped to improve greatly the maturity profile of Philippine external debt, with the share of short-term in total external debt declining from 38 percent at end-1983 to under 20 percent at end-1986.

d. Exchange rate developments

Beginning in October 1984, when a float of the exchange rate was introduced, the exchange system has remained free of administrative allocation. Also, foreign exchange holdings of commercial banks have not been restricted by administrative limitations. In this exchange market, during 1986, the peso depreciated by about 7 percent in nominal terms against the U.S. dollar, with no perceptible differential in the unofficial market. With price stability in the Philippines, and the weakening of the U.S. dollar, this meant a depreciation of 17.5 percent in real effective terms vis-a-vis the currencies of major trading partners (Chart 1). The overall gain in competitiveness since the establishment of the new exchange system in October 1984, assessed in the same way, is about 18 percent. The gains relative to the currencies of the Philippines' major Pacific region competitors, however, have been smaller; during 1986 the peso depreciated by 4 percent in real effective terms against these competitors.

e. Performance criteria

All quantitative performance criteria for end-October and end-December 1986 were met, with the exception of the end-December ceiling for base money (Table 4).

III. The Program for 1987

1. Strategy and growth objective

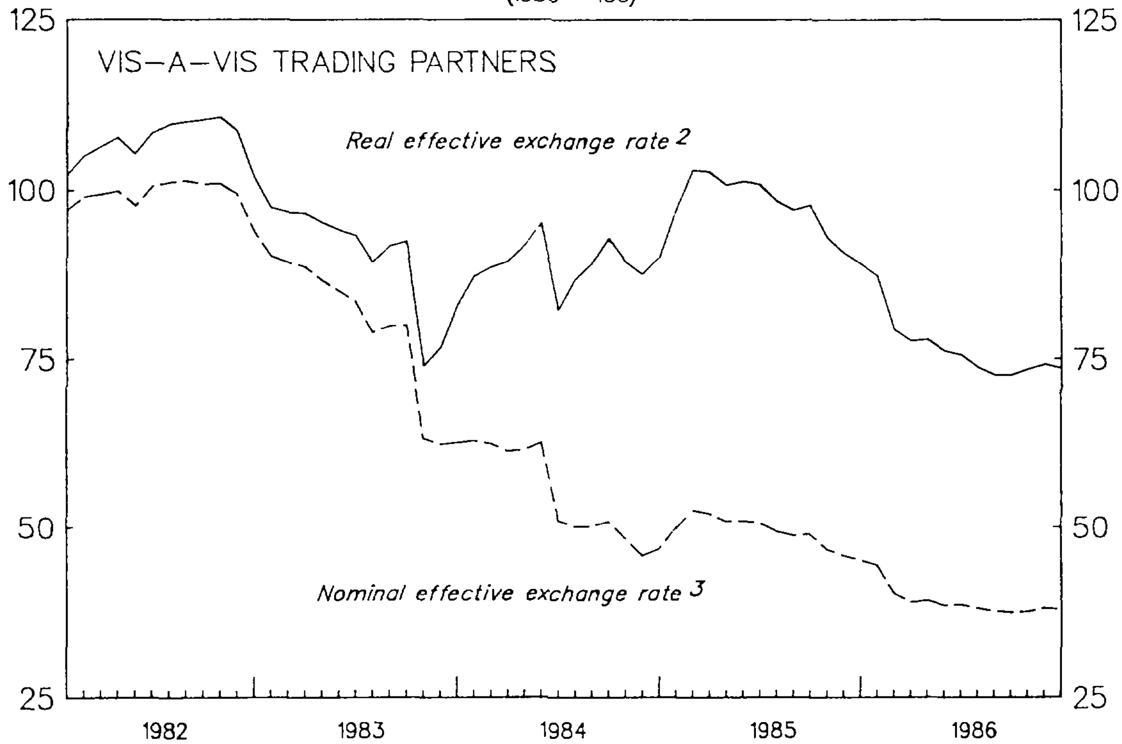
Although there have been delays in implementing some of the structural policies under the program that, together with prolonged uncertainties, limited the immediate success of the strategy, the authorities remain committed to the unfolding of policies in line with the macroeconomic and structural policy framework of the program. Thus, the 1987 program (Annex III) that has now been detailed in the new Memorandum on Economic Policies follows closely the original design. The financial program is modified slightly to incorporate developments in currency demand different from initial assumptions. The consolidated public sector deficit will be reduced further, to a level broadly in line with the original program, although the National Government (and hence the monitored PSBR) will assume a larger share of the consolidated deficit than was previously provided. The momentum of structural reform is to continue during 1987: residual elements of the 1986 tax reform

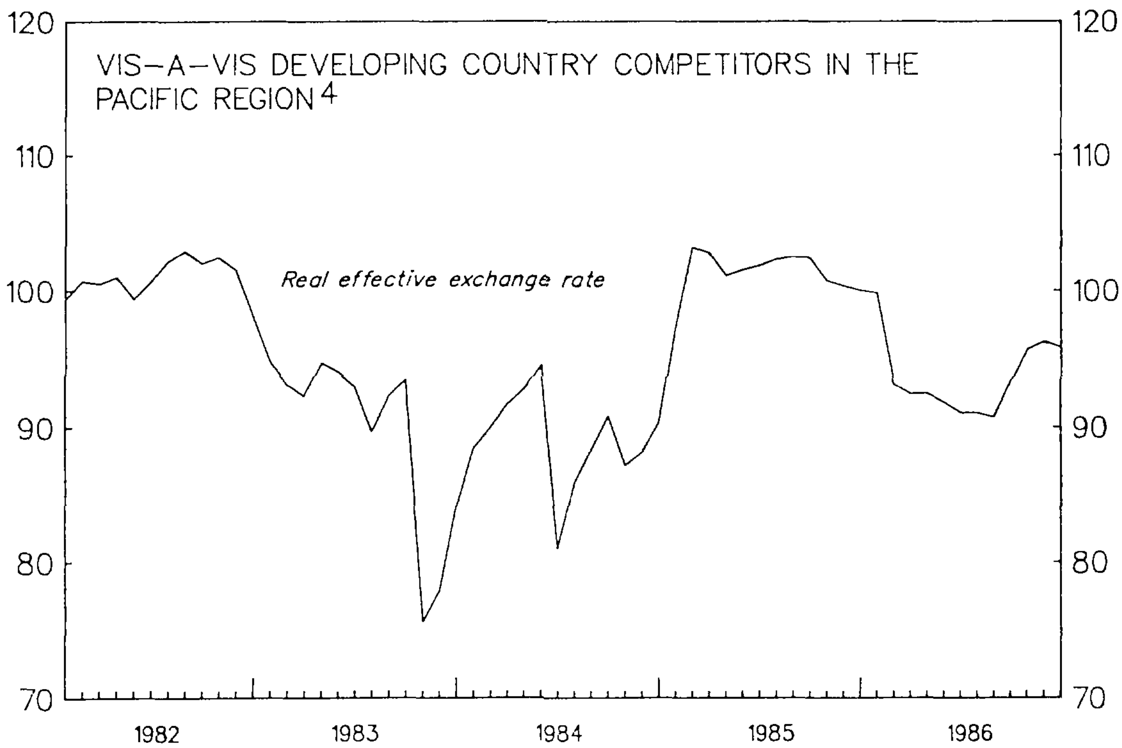
CHART 1

PHILIPPINES

REAL EFFECTIVE EXCHANGE RATE INDICES, 1982-86[1]

(1980 = 100)





Sources: Information Notice System; and Fund staff estimates.
[1] Upward movement indicates appreciation.
[2] Trade weighted index of nominal exchange rates deflated by seasonally adjusted relative prices.
[3] Trade weighted index of nominal exchange rates.
[4] The competitors included in the index are Hong Kong, Indonesia, Korea, Malaysia, Singapore, and Thailand, with weights determined by the value of each competitor's non-oil merchandise exports.

Table 3. Philippines: External Debt by Creditor, End-1986 1/

(In millions of U.S. dollars)

	Short-term	Medium- and long-term	Bonds	Total
Total	5,378	21,755	1,053	28,186
Commercial banks	3,771	11,444	141	15,356
Other financial institutions	22	264	542	828
Suppliers' credit	1,585	1,500	--	3,085
Multilateral	--	4,618	--	4,618
Of which: IMF 2/	(--)	(1,266)	(--)	(1,266)
Bilateral	--	3,922	3	3,925
Of which: export credit agencies	(--)	(1,332)	(--)	(1,332)
Other	--	7	367	374

Source: Data provided by the Philippine authorities.

1/ External debt valued in U.S. dollars at end-1986 exchange rates; data for earlier dates are contained in SM/86/249.
2/ Includes Trust Fund obligations of $93 million.

Table 4. Philippines: Compliance with Quantitative Performance Criteria, 1986

	1986				
	June 30	Oct. 31		Dec. 31	
	Actual	Ceiling	Actual	Ceiling	Actual
	(In billions of pesos)				
Money and credit					
Monetary base	43.0	47.7 1/ (47.5)	45.8	51.1 1/ (51.0)	53.4
Public sector borrowing requirement 2/	13.8	29.3	12.5	31.8 3/ (34.5)	25.5
Central Bank credit to PNB 4/	3.6	3.0	3.0	3.0	3.0
	(In millions of U.S. dollars)				
External sector					
Net international reserves of the monetary authority (floor)	-1,104	-1,493 5/ (-1,269)	-1,431	-1,308 5/ (-908)	-964
Short-term external debt outstanding	8,787	9,095	8,629	9,050	8,811
Approvals of external borrowing 6/					
Maturities of 1-12 years	...	1,400	8	1,400	76
Maturities of 1-5 years	...	300	1	300	2

Sources: Data provided by the Philippine authorities; and staff estimates.

1/ After adjustment for reductions in reserve requirements and the difference between actual NIR and the adjusted floor; figures in parentheses are the original ceilings.
2/ Cumulative from January 1, 1986.
3/ Adjusted for shortfall in National Government capital outlays from the targeted level; figure in parentheses is the unadjusted ceiling.
4/ Excluding eligible rediscounting.
5/ Adjusted NIR floors; the unadjusted floors are given in parentheses.
6/ Cumulative approvals from July 1, 1986 onward of all public and private sector foreign borrowing in the specified maturities, excluding reserve liabilities of the banking system and concessional loans (i.e. grant element of at least 25 percent).

package will be implemented in full by mid-year; a major reform of the nonfinancial public sector has been specified and will be initiated also by mid-year; there is to be further progress in import liberalization according to a new schedule; and, importantly, major bottlenecks to the implementation of the public investment program are to be alleviated.

The underlying conditions for an economic recovery in line with the program's objective appear to be more firmly established than at any other time in recent years. Many longstanding uncertainties that have affected private sector confidence have been reduced with the recent consolidation of the political situation, amendments to the labor code sought by the business sector, and successive expressions of external bilateral and multilateral support. The external situation, including the availability of financing, is also stronger than at any time since the outbreak of the crisis in October 1983. Domestic economic conditions have become more favorable with the further decline in interest rates, the increased provision for private sector credit in the 1987 financial program, and reviews of foreign investment policy that are expected to liberalize procedures and enhance the international attractiveness of Philippine investment opportunities.

Various specific measures are also being taken by the authorities to redress identified weaknesses that limited the recovery in 1986. Thus, the constraints that led to a virtual suspension of private housing finance in 1986 have been reduced through new guidelines and financial provisions for the extension of such finance by a number of housing and other government agencies; and factors that have delayed implementation of the Community Employment and Development Program, a major new instrument for the implementation of decentralized public infrastructural projects, are being addressed. Both these initiatives are expected to reverse the years of decline in the construction sector, and lead the recovery in total investment. Also, the further progress in liberalizing the import system will stimulate fixed and inventory investment demand in import-intensive industries. Overall, a substantial rebound in inventories is expected during 1987, and recent indicators point to the process being underway.

While the recovery in investment (from 14 percent of GNP in 1986 to over 17 percent in 1987) will lead the overall recovery, other recent stimuli to demand are also likely to strengthen during 1987. Thus, rural incomes have already been significantly buoyed by the near doubling in farmgate copra prices, a result not only of a turnaround in the international price but also of increased domestic competition following structural reforms (Section IV.4).

2. External policies

a. Balance of payments and financing

The external environment will continue to favor the Philippines in 1987. Despite higher oil prices, the Philippines is expected to benefit from terms of trade developments during 1987 that are more favorable than originally projected. Beyond this, there has been a substantial improvement in aid prospects that is expected to result in a greater availability of external finance in the form of both loans and grants. Thus, with this easing in the short run of the external constraint, there is substantial flexibility in accommodating the rebound in non-oil imports expected with the recovery and the progress made thus far in liberalizing the import system. Even with a projected growth in the value of non-oil imports of 23 percent (about 18 percent in volume terms), a substantial portion of which is intended for the restocking of inventories depleted in recent years, the current account will remain in small surplus (0.7 percent of GNP) in 1987 (Table 5).

Although export performance in 1987 is projected to exceed original program projections, this is representative of the improvement in the dollar export prices of traditional commodities rather than of a fundamental change in underlying export trends. However, the performance of nontraditional exports, in particular electronics, garments, and a wide range of small manufactures, is expected to strengthen (with a projected increase in value of 14 percent) with an assumed modest increase in market shares and entry into new markets.

The improved prospects for aid and other inflows from bilateral and multilateral sources result in: (i) a projected doubling (over program estimates) of disbursements out of the Economic Support Fund of the United States; (ii) a substantial rise in transfers; and (iii) a large spontaneous increase in disbursements from commitments made after end-December 1985. At the same time, the net outflow in the short-term capital account is projected to fall substantially from 1986 since the decline in oil-related trade credits has already been experienced in 1986 and only limited further growth is anticipated in export financing.

The overall balance of payments before exceptional financing is projected to be in deficit by $0.4 billion in 1987, broadly unchanged from 1986. The rescheduling with the participants in the Paris Club (already agreed in principle 1/) and the anticipated rescheduling with foreign commercial banks would cover this deficit and also allow, by end-year, a further restoration of gross official reserves, to 3.8 months of projected 1988 imports. Thus, the 1987 balance of

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1/ Details of the Paris Club agreement, reached on January 22, 1987, are provided in SM/87/47, 2/18/87.

Table 5. Philippines: Balance of Payments, 1984-87

(In millions of U.S. dollars)

	1984	1985	1986		1987	
			Program	Actual	Program	Revised Program
Trade balance	-679	-482	-550	-120	-808	-725
Exports, f.o.b.	5,391	4,629	4,600	4,780	4,972	5,275
Imports, f.o.b.	-6,070	-5,111	-5,150	-4,900	-5,780	-6,000
Oil	-1,472	-1,278	-761	-770	-780	-933
Non-oil	-4,598	-3,833	-4,389	-4,130	-5,000	-5,067
(Percentage change)	-20.0	-16.6	14.5	7.7	13.9	22.7
Services	-975	111	427	676	-37	344
Receipts	2,626	3,288	3,517	3,802	3,488	3,796
Of which: ESF	(52)	(62)	(300)	(300)	(95)	(220)
Payments	-3,601	-3,177	-3,090	-3,126	-3,525	-3,452
Of which: interest	(-2,330)	(-2,213)	(-1,940)	(-2,041)	(-2,165)	(-2,113)
Transfers	386	379	406	432	426	614
Current account	-1,268	8	283	988	-419	233
(as percent of GNP)	(-4.0)	(--)	(0.9)	(3.3)	(-1.2)	(0.7)
Capital account (net)	1,068	-730	-833	-1,376	-69	-585
Direct investment (net)	6	-9	80	136	100	142
Medium- and long-term loans (net)	366	-784	-802	-820	-699	-792
Inflows	1,367	670	1,093	910	1,162	1,183
Pipeline	730	428	854	664	433	430
New commitments	637	242	239 1/	246 1/	729 1/	753 1/
Outflows	-1,001	-1,454	-1,895	-1,730	-1,861	-1,975
Short-term capital (net)	18	-1,526	-283	-851	297	-242
Other financing (net) 2/	618	818	--	--	--	--
Monetization of gold, valuation adjustments, and net errors and omissions	60	771	172	159	233	307
Overall balance	-200	-722	-550	-388	-488	-352
Finance	200	722	550	388	488	352
Net international reserves (- increase) 3/	200	-2,789	-1,167	-1,247	-836	-1,200
Assets (- increase)	-202	-254	-679	-1,377	-314	-1,100
Liabilities	402	-2,535	-488	130	-522	-100
Use of Fund credit (net)	-128	178	39	27	-78	-100
Purchases	84	340	287	275	192	193
Repurchases	-212	-162	-248	-248	-270	-293
Other 4/	530	-2,713	-527	103	-444	1
Financing gap	--	3,511	1,717	1,635	1,324	1,552
Identified exceptional finance	--	3,511	1,717	1,635	1,324	604
Rescheduling	--	3,111	1,192	1,110	1,324	604
Paris Club	--	660	379	379	...	604
Commercial banks	--	2,410	813	731 5/	...	--
Suppliers	--	41	--	--	--	--
Concerted bank lending	--	400	525	525	--	--
Residual exceptional finance	--	--	--	--	--	947 6/
Memorandum items:						
Gross official reserves	886	1,061	2,400	2,459	2,700	3,383
(months of following year's imports of goods and services)	1.3	1.6	3.1	3.1	3.2	3.8

Sources: Data provided by the Philippine authorities; and staff estimates.

1/ Commitments made after December 31, 1985.
2/ Includes rollover of short-term maturities and extension of import financing maturities in 1984;
and unremittable arrears and rollover of nonmonetary trade arrears in 1985.
3/ Change in net international reserves of the banking system (including change in non-monetary
arrears).
4/ Includes change in arrears (in 1984 and 1985), utilization of the trade facility, and changes in other monetary liabilities.
5/ In addition, $135 million of monetary liabilities of domestic commercial banks were rescheduled with foreign commercial banks.
6/ Amount expected to be rescheduled by commercial banks.

payments does not require a concerted new money package from commercial banks. After taking account of the agreed and anticipated reschedulings, net international reserves of the banking system are projected to rise by $1.2 billion in 1987. Consistent with this projection, quarterly floors for net international reserves of the monetary authorities have been established which will constitute performance criteria under the arrangement.

b. Exchange rate and trade policies

The medium-term success of the economic strategy depends importantly upon its outward orientation through liberal trade policies and a supportive exchange rate policy that enhances the relative competitiveness of the Philippine traded goods sector in relation to that of competitor countries. However, in the short run, the enhanced availability of foreign exchange during a period when import demand has yet to recover in line with the medium-term growth of the economy may conflict with the medium-term objective of enhancing competitiveness. In this interim period, Central Bank intervention policy will aim at ensuring that the exchange rate that develops in the exchange market is consistent with the desired medium-term trend, while taking account of the domestic monetary implications of intervention.

Adherence to NIR targets will be one guide to the conduct of Central Bank intervention policy. Other criteria that have guided the conduct of exchange rate policy since the exchange rate reform of October 1984 will continue to apply. Thus: (i) foreign exchange holdings of commercial banks will remain free of administrative limitations; (ii) the authorities will seek to ensure that the differential between rates in the official and parallel markets for foreign exchange remains insignificant; and (iii) the authorities will seek to maintain the competitive position of the Philippines in relation to Pacific competitors.

While the demand for foreign exchange is likely to be strengthened *pari passu* with the economic recovery, the authorities will seek to enhance this demand by continuing with the thrust of import liberalization. Thus, the authorities have recently announced new schedules for the liberalization of a number of items (Table 6) that complete the liberalization program agreed with the previous government within the time frame envisaged in the authorities' Memorandum on Economic Policies of September 1986. Furthermore, the authorities have reduced, effective April 15, 1987, the requirement for marginal deposits against import letters of credit from 100 percent to 50 percent.

As part of the 1986 tax reform, a minimum tariff of 10 percent was established for all items that were previously zero rated in the import code or were taxed at rates below 10 percent. The tariff reform is continuing, and the Government has indicated, in the context of the

Table 6. Philippines: Import Liberalization Policy

	Total number of items	Liberalized as of end-Feb. 1987	Number remaining as of end-Feb. 1987	Schedule for Further Liberalization: End-March 1987	End-June 1987	End-Oct. 1987	End-Dec. 1987	End-Apr 1988
I. Previously agreed schedule	1,232	936	293 1/ 2/	12	12	72	64	132
Items scheduled for end-April 1986	904	846	55 1/ 2/	--	7	--	13	34
Items scheduled for end-December 1986	249	88	161	12	5	72	51	21
Items scheduled for end-June 1987 3/	79	2	77	--	--	--	--	77
II. Remaining areas of import controls								
Items under "progressive" manufacturing program 4/	100-200	--	100-200	--	--		--	--
Consumer goods	30-40	--	30-40	--	--		--	--
Miscellaneous items, mainly agricultural and livestock related, newsprint, coal, refined petroleum products, and antibiotics	100-200	--	100-120	--	--		--	--
Items regulated for health, safety and national security reasons	100-150	--	100-150	--	--		--	--
III. Capital goods	Monthly exceeding $50,000	Restriction lifted						

Source: Based on data provided by the Philippine authorities.

1/ Three sugar items have been removed from the schedule, in line with domestic policy, leaving unimplemented 55 items from the original schedule.
2/ Includes one item, scheduled for liberalization at end-December 1986, which is still pending.
3/ Fabrics and textiles.
4/ To be reviewed with World Bank staff as part of industrial policy.

negotiations on the World Bank's Economic Recovery Loan, that another review of the tariff structure will be undertaken, with the objective of further reducing the highest tariff rates (already agreed to be limited to 50 percent), and achieving a more even structure of nominal protection of around 20-30 percent. Studies of the tariff system are expected to be completed by August 1987, and a new tariff schedule to be announced before the end of 1988.

c. Foreign investment policy

Major aspects of foreign investment policy are under review. A scheme that provides for the conversion of external debt into equity became operational in 1986. Details of the scheme and its progress thus far are contained in Annex IV. Beyond this, the Government is in the final stages of completing an Omnibus Investment Code that is intended to offer a package of 5-year investment incentives tailored closely to those offered by some other ASEAN countries. The authorities are taking care to ensure that the provisions of the new investment code do not conflict with aspects of the 1986 tax reform package.

3. Public finances

a. The consolidated public sector

At the heart of the program is the intended reform of the public sector, its claims on resources, its efficiency, and its institutions. A key objective is to reduce the consolidated public sector deficit (including the GFI and Central Bank losses) to about 5 percent of GNP in 1988. As reviewed in Section II.2 above, difficulties in implementing the public investment program resulted in the consolidated deficit being held well below the program level in 1986. Despite an expected recovery in public investment in 1987, further progress is planned in reducing the consolidated deficit, to 5.4 percent of GNP in 1987, broadly in line with the program path (Table 7).

Within the total consolidated public sector, the monitored deficit (PSBR) is projected to be above the original 1987 program because of the national government finances. In aggregate, the deficit of other components of the consolidated public sector will be reduced ahead of the program path.

The restructuring of the two major GFIs 1/ has resulted, as anticipated, in a large portion of their liabilities (and the associated

1/ The Philippine National Bank (PNB) and the Development Bank of the Philippines (DBP).

Table 7. Philippines: Consolidated Public Sector Deficit, 1984-87 1/

(In billions of pesos)

	1984	1985	1986 Prog.	1986 Actual	1987 Orig. Prog.	1987 Rev. Prog.
National government deficit	-9.8	-11.2	-27.9	-28.1	-17.0	-20.7 2/
Monitored corporations deficit	-11.6	-8.1	-14.3	-8.8	-11.2	-10.0 2/
Net transfers between the National Government and monitored corporations	5.7	3.6	7.7	11.4 3/	7.8	6.8 3/
Monitored public sector borrowing requirement (PSBR)	-15.7	-15.7	-34.5	-25.5	-20.4	-23.9
Other nonfinancial public sector 4/	-0.2	0.9	0.9	1.1	0.5	0.5
National Government transfers to other nonfinancial public sector	1.0	1.8	1.7	2.0	1.2	1.5
Consolidated nonfinancial public sector deficit	-14.9	-13.0	-31.9	-22.4	-18.7	-21.9
GFIs deficit	-8.5	-18.5	-14.4	-12.4	-10.9	0.4 5/
Net income of Central Bank	-27.6	-15.5	-21.7	-16.9	-16.2	-15.2
Net transfers between the National Government and the GFIs	7.3	10.7	20.5	16.2 6/	9.2	0.2 6/
Consolidated public sector deficit 7/	-43.7	-36.3	-47.5	-35.5	-36.6	-36.5
Memorandum items:						
Financing of PSBR	15.7	15.7	34.5	25.5	20.4	23.9
Net external	8.0	-2.7	4.6	-3.3	8.1	13.0
Net domestic	7.7	18.4	29.9	28.8	12.3	10.9
Bank	...	0.6	3.8	-5.9	...	-30.0
Nonbank	...	18.0	26.1	34.7	...	40.9
			(As percent of GNP)			
National government deficit	-1.9	-1.9	-4.4	-4.7	-2.4	-3.1
PSBR	-3.0	-2.6	-5.5	-4.2	-2.9	-3.5
Consolidated public sector deficit	-8.3	-6.1	-7.5	-5.9	-5.2	-5.4

Sources: Data provided by the Philippine authorities; and staff estimates.

1/ The PSBR, the National Government deficit, and the corresponding financing data do not include entries reflective of the Government's assumption of the stocks of certain debts and deposit liabilities of the GFIs as of June 30, 1986 (about ₱ 108 billion). Interest payments on the transferred liabilities are included in the National Government deficit and the PSBR, while transfers to the GFIs are reduced by a broadly similar amount. The net result of the transactions was to raise slightly the PSBR in 1986 and to leave the 1987 PSBR unchanged.

2/ Expenditures for PNPP, which were included in the monitored corporations deficit in the original program, are now included in the National Government deficit because of the transfer of PNPP's liabilities to the National Government effective July 1, 1986.

3/ Includes transfers of ₱ 1.2 billion from the NPC to the National Government in 1986 (related to the National Government's assumption of PNPP debt servicing) and the reverse transfer of the same amount in 1987.

4 Includes other nonfinancial public corporations, local governments, and the social security systems.

5/ After the restructuring of the PNB and the DBP that has resulted in a transfer of certain debt service payments to the National Government.

6/ Includes a transfer of ₱ 0.7 billion from the PNB to the National Government (related to the National Government's assumption of PNB debt servicing), and a reverse transfer of the same amount in 1987.

7/ Financing transactions between the nonfinancial public sector and the public financial sector are not consolidated.

debt service) being transferred to the National Government. 1/ After this restructuring, the two institutions are projected to be in surplus in 1987, in part also because of a cutback in their staff and branch networks (Section IV.3 below) (Table 8). These surpluses are expected to outweigh the continuing deficit of the third GFI, Philguarantee, which has not yet been restructured.

The deficit of the Central Bank is expected to decline further, to about P 15 billion (2.3 percent of GNP) in 1987, largely as a result of the impact, over a full year, of the decline in domestic and foreign interest rates that occurred in the second half of 1986. The immediate impact on the Central Bank's deficit of the substitution of Treasury bills for most maturing Central Bank bills (a change in the conduct of open market policy described in Section III.3.d below) will be small, since the Bank will continue to pay market-related interest rates on most of the corresponding increase in Treasury deposits.

b. National Government

A number of structural changes have achieved greater transparency in the presentation of the national government accounts, made more explicit previously implicit subsidies, and resulted in the consolidation within the National Government of ad hoc financing transactions previously undertaken by the GFIs as a substitute for fundamental reform. Thus, the 1987 national government budget reflects: (i) the debt service impact of the transfer to the National Government of a large part of the liabilities of the GFIs; (ii) a similar consolidation of the finances of the abandoned nuclear power plant, previously part of the National Power Corporation (NPC); (iii) budgetary provision for the settlement of some arrears of the nonfinancial corporations; (iv) the elimination of longstanding fiscal exemptions and their replacement, in the form of explicit budgetary provision, by subsidies where deemed necessary; and (v) an increased issue of Treasury bills, and corresponding deposits with the Central Bank, to replace maturing Central Bank bills. These changes have strengthened greatly the role and coverage of the national government budget (Table 9).

The 1987 revenue target of P 100 billion reflects three component developments: (i) the first full-year impact of the 1986 tax reform

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1/ The net impact on the overall consolidated public sector is, however, broadly neutral since National Government transfers to the GFIs are also reduced correspondingly. Interest payments on the transferred liabilities are included in the National Government deficit, but the actual transfer of the stock of liabilities, which took place effective June 30, 1986, is not included in the monitored PSBR.

Table 8. Philippines: Deficits of the Three Major Public Financial Corporations, 1984-88

(In billions of pesos)

	1984	1985	1986 Program	1986 Actual	1987 Original program	1987 Rev. 1/ program	1988
Domestic operating surplus/deficit (-)	-2.3	-6.9	-5.7	-4.8	... 2/	0.3	0.4
PNB	-1.7	-5.7	-3.7	-3.8	...	0.2	0.3
DBP	-0.6	-1.2	-2.0	-1.0	...	0.1	0.1
Philguarantee	--	--	--	--	--	--	--
Foreign interest payments and net payments on foreign guarantees 3/	-6.3	-11.9	-10.0	-7.7	-7.1	-0.3	0.2
PNB	-2.5	-2.2	-3.8	-1.8	-1.9	0.3	0.3
DBP	-3.6	-8.7	-4.6	-4.5	-4.5	0.2	0.2
Philguarantee	-0.2	-1.0	-1.6	-1.4	-0.7	-0.8	-0.3
Surplus/deficit (-) on other operations 4/	0.1	0.3	1.3	--	... 2/	0.5	0.2
PNB	-0.1	-0.1	0.4	-0.1	...	0.3	0.2
DBP	0.3	0.4	0.9	0.1	...	0.2	--
Philguarantee	-0.1	--	--	--	--	--	--
Overall deficit	-8.5	-18.5	-14.4	-12.4	-10.9	0.4	0.8
PNB	-4.3	-8.0	-7.1	-5.7	-4.8	0.8	0.8
DBP	-3.9	-9.5	-5.7	-5.4	-5.4	0.5	0.3
Philguarantee	-0.3	-1.0	-1.6	-1.4	-0.7	-0.8	-0.3
Memorandum items:							
Foreign debt service, after rescheduling 5/	6.6	16.1	11.1	9.1	10.6	1.3	0.8
PNB	2.7	5.0	4.5	2.9	4.1	0.3 6/	0.3 6/
DBP	3.7	10.1	5.3	5.2	5.7	--	-- 6/
Philguarantee	0.2	1.0	1.3	1.0	0.8	1.0	0.5
Transfers from National Government	7.3	10.7	20.5	15.5	9.2	0.8	0.4
PNB	1.0	1.5	11.0	6.4	2.8	--	--
DBP	5.5	8.3	7.6	8.0	5.7	--	--
Philguarantee	0.8	0.9	1.9	1.1	0.7	0.8	0.4

Sources: Data supplied by the Philippine authorities; and staff estimates. Totals may not add due to rounding.

1/ After restructuring of PNB and DBP.

2/ A precise disaggregation of the targeted deficit into its domestic components had not yet been established at the time, since it was dependent on the final shape of the GFI reform proposals.

3/ After debt rescheduling in 1985-88, and net of collections on foreign guarantees.

4/ Includes net payments on domestic guarantees, capital expenditures, and sales of assets.

5/ Foreign debt service includes interest and principal payments on foreign loans plus gross advances on foreign guarantees.

6/ Debt service on liabilities retained after restructuring. Foreign debt service in 1987 on liabilities transferred to the National Government are estimated at P2.2 billion for PNB and P5.3 billion for DBP.

Table 9. Philippines: National Government Budget, 1984-87

(In billions of pesos)

	1984	1985	1986 Program	1986 Actual	1987 Original Program	1987 Revised Program
Revenues and grants	56.9	68.9	86.5	79.1	102.2	100.0
Domestic-based taxes	32.2	42.8	55.1	47.4	63.4	58.9
International trade taxes	17.8	18.4	20.7	17.8	27.2	24.1
Nontax revenue (including ESF)	6.9	7.7	12.7	13.9	11.6	18.9
Provision for shortfall	--	--	-2.0	--	--	-1.8
Expenditures and net lending	66.7	80.1	114.4	107.2	119.2	120.7
Current operating expenditure	42.9	54.0	68.6 1/	66.3 1/	82.1 1/	92.4
of which:						
Maintenance and operating	(12.4)	(13.2)	(21.5)	(15.0)	(25.3)	(22.9)
Interest payments	(10.4)	(14.7)	(16.9)	(21.6)	(18.5)	(29.0)
Subsidies	(0.4)	(1.0)	(2.8)	(2.2)	(7.7)	(6.3)
of which: Tax expenditures	--	--	1.6	--	6.5	3.8
Capital expenditure	9.8	10.1	15.9 1/	13.2 1/	18.5 1/	17.9
Equity and net lending	14.0	16.0	29.9	27.7	18.6	10.4
of which: Assistance to GFIs	(8.4)	(10.7)	(20.9)	(16.1)	(9.6)	(1.3)
Deficit (-)	-9.8	-11.2	-27.9	-28.1	-17.0	-20.7
Financing	9.8	11.2	27.9	28.1	17.0	20.7
Foreign (net)	1.9	-0.3	6.8	2.0	9.4	12.0
Gross borrowings	(4.6)	(3.7)	(13.3)	(9.3)	(15.6)	(19.8)
Amortization	(-2.7)	(-4.0)	(-6.5)	(-7.3)	(-6.2)	(-7.8)
Domestic (net)	7.9	11.5	21.1	26.1	7.6	8.7
Bank 2/	(1.7)	(0.2)	(3.7)	(-4.6)	(...)	(-30.2)
Nonbank 2/	(6.2)	(11.3)	(17.4)	(30.7)	(...)	(38.9)
			(In percent of GNP)			
Memorandum items:						
Tax revenue	9.5	10.3	12.0	10.8	12.8	12.3
Expenditure and net lending	12.7	13.5	18.1	17.8	16.8	17.9
Capital outlays and maintenance	4.2	3.9	5.9	4.7	6.2	6.0
Assistance to GFIs	1.6	1.8	3.3	2.7	1.3	0.2
Deficit	-1.9	-1.9	-4.4	-4.7	-2.4	-3.1
Estimated balance on domestic transactions (billion pesos) (deficit -)	...	3.4	-8.5	-4.8	9.8	3.6
Public sector debt outstanding (billion pesos, end period) 3/	70.9	95.8	138.2	126.0	175.6	192.8
Issued by						
National Government	50.1	59.3	79.4	89.8	84.2	155.9
Central Bank	18.6	34.3 4/	58.8 4/	31.8 4/	91.4 4/	32.5 4/
Monitored corporations	2.2	2.2	--	4.4	--	4.4

Source: Data provided by the Philippine authorities.

1/ Adjusted to reflect reclassification of transfers to local government units to finance capital projects (P 1.2 billion for 1986 and P 1.4 million for 1987).
2/ Data on financing are taken from Treasury sources for 1984-85 and from the monetary survey for 1986.
3/ Excludes public sector securities held by the monetary authorities, but includes securities held by commercial banks.
4/ Includes about P 2.1 billion of dollar-denominated securities.

package, estimated at over ₱ 15 billion; 1/ (ii) an assumed 7 percent rise in revenue other than from discretionary changes, a reasonable estimate given the traditionally low elasticity of the Philippine tax system; and (iii) a substantial rise in nontax revenue, principally reflecting sales of sequestered and other assets (₱ 2.5 billion), the effect of new structural policies requiring nonfinancial corporations to make interest and dividend payments on net lending and profits, respectively (₱ 1.3 billion), as well as increased interest receipts on Treasury deposits with the Central Bank (₱ 1.7 billion). The tax-GNP ratio is projected to rise from 10.8 percent in 1986 to 12.3 percent in 1987, a feasible target provided there are no further slippages in the implementation of remaining elements of the 1986 tax reform package (Section IV below).

The 1987 expenditure target of about ₱ 121 billion allows for: (i) substantial increases in maintenance and investment outlays, 53 percent and 36 percent respectively, judged essential and feasible by World Bank staff (Annex V), but which will require swift and substantial improvements in implementation efficiency; and (ii) a 25 percent increase in personnel payments related to a major restructuring of the national government compensation system aimed at reversing longstanding distortions in relative pay and in the wage structure (described in Section III.4 below). Should unplanned shortfalls occur, the authorities have installed new control mechanisms to prevent a reallocation of budget appropriations between expenditure categories.

A disaggregation of revenues and expenditures into their domestic and foreign components indicates that the balance on domestic transactions will be in surplus, reflecting large national government interest payments abroad (which include, beginning in 1987, the external debt service of the two major GFIs).

c. The monitored public corporations

As with the National Government, the 1987 cash flow projections of the 14 major public corporations reflect structural changes that have increased the transparency of their operations. Thus, assumptions related to the payment of interest and dividends to the National Government have been incorporated, as have also assumptions related to the settlement of some of the arrears of the corporations.

The 1987 financing requirement of the monitored corporations is expected to rise slightly from its relatively low 1986 level to

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1/ The program projection of 1987 total revenues includes provision for a shortfall of ₱ 1.8 billion from official estimates, because more than a third of the gross yield of the tax reform package derives from administrative measures (₱ 5.8 billion) where projections of yield cannot be made with precision.

₱ 10 billion (1.5 percent of GNP), due largely to the acceleration in capital expenditure (Table 10). As in the past, the NPC, the National Food Authority (NFA), and the National Irrigation Administration (NIA) dominate the overall cash balances within the aggregate for the 14 corporations.

Aggregate capital expenditure of the 14 corporations is expected to virtually double over 1986 when implementation delays kept the investment program well below the targeted level. This increase (assessed by the World Bank staff in Annex V) is deemed necessary to rehabilitate and replace capacity and to raise the productivity of the enterprises. Its implementation, however, will require, not only adequate financing, but also a substantial improvement in program design and administration. The NPC's investment in energy capacity alone accounts for about a third of total 1987 capital expenditure of the corporations. The investment program of the other corporations is focused in the areas of water, small irrigation projects, and low cost housing. Included also in aggregate capital expenditure is the effect of the further accumulation of rice stocks by the NFA as part of its stabilization policy.

Traditionally, internal cash generation by the 14 corporations has been negligible, reflecting subsidized pricing policies and major billing and collection inefficiencies. The structural changes planned (Section IV.2 below) are intended to raise the medium-term internal resource generation capacity of the entities that will remain in the public sector after completion of the envisaged restructuring. For 1987, the projected strengthening in the internal cash position of the corporations reflects: (i) for the NPC, implementation of a major tariff reform during the year, a higher sales volume expected with the recovery, and the collection of arrears due from MERALCO, a retailer of electricity in the Manila metropolitan area; (ii) an increase in domestic oil prices that will raise revenues of the Philippine National Oil Corporation (PNOC) as well as the collection of arrears owed to the PNOC from the National Government; (iii) the anticipated sale of some of the subsidiaries of the National Development Corporation; and (iv) improvements in the billing and collection efficiency of the Metropolitan Waterworks and Sewerage System, in the context of a reform program being undertaken with the World Bank.

d. The financing of the monitored public sector deficit

Consistent with the revised projections for the National Government and the 14 major public corporations, the public sector borrowing requirement (PSBR) of the monitored public sector is to be limited to ₱ 23.9 billion (3.5 percent of GNP) in 1987, somewhat above the original program target of ₱ 20.4 billion or 2.9 percent of GNP. In line with the revised 1987 target, quarterly cumulative limits have been set that limit the PSBR to ₱ 6.8 billion at end-March 1987 (requiring a modification of the previously established limit of ₱ 5.0 billion), to

Table 10. Philippines: Cash Flows of the Major Nonfinancial Public Corporations, 1984-87

(In billions of pesos)

	1984	1985	1986 1/ Prog.	1986 1/ Act.	1987 2/ Revised program
Internal cash generation	1.8	4.2	-0.6	0.3	3.9
National Power Corporation	0.3	1.4	1.1	2.4	5.4 3/
Philippine National Oil Corporation	1.9	1.4	-0.4	-0.2	0.9
Metropolitan Water and Sewerage System	0.3	0.4	0.7	0.4	0.1
National Irrigation Administration	-0.2	-0.3	-0.7	-0.7	-1.1
National Development Company	-0.1	--	0.3	-0.1	0.4
Light Rail Transit Authority	-0.2	-0.1	-0.3	-0.2	-0.2
National Electrification Administration	-0.3	-0.3	-0.3	-0.3	-0.5
National Housing Authority	--	0.1	--	--	0.3
National Food Authority	...	1.1	-1.4	-1.4	-1.5
Other 4/	0.1	0.5	0.1	0.4	0.1
Capital expenditure	13.4	12.3	13.6	7.9	15.1
National Power Corporation	7.1	5.3	8.0	4.6	5.2
Philippine National Oil Corporation	0.9	-0.5	-0.6	-0.7	1.7
Metropolitan Water and Sewerage System	1.2	1.2	1.9	0.6	1.6
National Irrigation Administration	1.9	1.7	1.8	1.6	2.2
National Development Company	0.2	0.6	0.1	--	0.3
Light Rail Transit Authority	0.6	0.2	0.2	--	--
National Electrification Administration	0.5	0.3	0.2	0.2	0.5
National Housing Authority	0.5	0.6	0.5	0.3	0.8
National Food Authority	...	2.1	0.5	0.7	1.2
Other 4/	0.5	0.8	1.2	0.6	1.6
Capital transfers	--	--	--	1.2	-1.2
National Power Corporations	--	--	--	1.2	-1.2
Overall cash deficit	-11.6	-8.1	-14.2	-8.8	-10.0
National Power Corporation	-6.8	-3.9	-6.9	-3.5	1.3
Philippine National Oil Corporation	1.0	2.0	0.3	0.4	-0.8
Metropolitan Water and Sewerage System	-1.0	-0.8	-1.2	-0.2	-1.5
National Irrigation Administration	-2.0	-2.0	-2.5	-2.2	-3.3
National Development Company	-0.3	-0.5	0.2	--	--
Light Rail Transit Authority	-0.8	-0.2	-0.4	-0.3	-0.3
National Electrification Administration	-0.8	-0.5	-0.5	-0.5	-0.9
National Housing Authority	-0.5	-0.5	-0.5	-0.3	-0.4
National Food Authority	...	-1.1	-1.9	-2.1	-2.7
Other 4/	-0.4	-0.4	-0.8	-0.1	-1.4
Combined financing requirement	11.6	8.1	14.2	8.8	10.0
(Percent of GNP)	(2.2)	(1.4)	(2.3)	(1.5)	(1.5)
External financing (net)	6.1	-2.4	-2.2	-5.3	1.0
Domestic financing (net)	5.5	10.5	16.4	14.1	9.0
Of which: National Government transfers	(5.7)	(3.5)	(7.7)	(10.2)	(8.0)

Source: Data provided by the Philippine authorities.

1/ Includes PNPP.
2/ Excludes PNPP, whose financial accounting has been consolidated with the National Government.
3/ Includes a receipt of P1.0 billion in arrears from MERALCO.
4/ Comprises Export Processing Zone Authority, Local Water Utilities Administration, Metro Manila Transit Corporation, Philippine National Railways, and Philippine Port Authority.

₱ 13.3 billion at end-June 1987, to ₱ 17.8 billion at end-September 1987, and to ₱ 23.9 billion at end-December 1987.

The contribution of net external financing is expected to be substantial, in line with the higher aid inflows in the balance of payments, and to account for over half of the PSBR. The bulk of it will accrue to the National Government, where the net reliance on foreign financing is projected to constitute an even greater proportion of the deficit.

Domestic financing of the PSBR, at ₱ 10.9 billion, will be the net outcome of a much enhanced Treasury bill operation that would accommodate a number of structural changes in open market and other financing policies. The need for the issuance of Treasury bills beyond the domestic financing of the National Government deficit (Table 9) results from: (i) the recent change in open market policy aimed at gradually shifting the instrument of policy toward Treasury securities that would substitute for Central Bank bills; and (ii) the consolidation of GFI liabilities with the National Government that will require additional Treasury bill sales to finance a rundown in those deposit liabilities of the GFIs that are assumed by the National Government. 1/ Since these operations consist of a substitution within existing asset portfolios, they are not expected to exert significant upward pressure on interest rates.

In aggregate, the total stock of public sector securities 2/ is expected to rise from ₱ 126 billion at end-1986 to ₱ 193 billion at end-1987 reflecting, in addition to the factors summarized above, the Central Bank deficit and the need for substantial additional open market operations to offset the decline in the contractionary effect that was experienced in 1985-86 from the assumption of private sector foreign liabilities by the Central Bank.

4. Incomes policy

A major change in National Government compensation policy is planned during 1987 that will have the effect of raising personnel service payments by about 25 percent over 1986. On average, National Government compensation per employee is projected to rise by 24 percent, a result of "mandatory" and "discretionary" increases. The mandatory component (almost 30 percent of the total increase in National Government personnel payments) derives from the full year effect of the 1986 wage increase and provisions in the new Constitution that mandate

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1/ In the past, in attempts to limit the cash deficits of the GFIs, the drawdown of these deposit liabilities had, in some cases, been effectively blocked.

2/ Securities of the National Government, the Central Bank, and the monitored corporations but excluding those held by the Central Bank.

higher salaries for about 250 senior officials, including the President, as well as the costs of convening a new Congress. Just under half of the total increase in personnel payments derives from discretionary measures aimed at: (i) reversing the decade-long decline in the real wage of National Government employees; (ii) addressing identified anomalies in the wage structure that have kept the compensation of specific groups of employees (particularly teachers) well below the average of other National Government employees; and (iii) the costs of new hirings to address chronic shortages in special occupational categories such as teachers and social workers. The remainder of the increase in personnel payments (just under one quarter of the total increase) reflects a new one-time payment to compensate for the erosion in medical allowances.

The discretionary increase in the wage structure consists of a basic 5 percent increase in the compensation of all National Government employees (0.9 million), coupled with varying specific increases for various occupational categories; the overall effect is to raise average National Government compensation per employee by about 10 percent over 1986. It is estimated that about half of the incremental outlays resulting from the discretionary increase will accrue to teachers.

The authorities emphasized that, even after this increase, half of National Government employees will remain below both private sector wage levels and a defined poverty line; and that the average compensation of teachers at the minimum grade level in 1987 will remain below the overall average for National Government employees. Because of these factors, they did not expect the increases to result in a general upward shift in wage rates in the rest of the economy.

The authorities are determined to maintain the present employment level in the National Government, other than the exceptions cited above for teachers and other occupational groups where chronic shortages exist. Overall, the increase in National Government employment in 1987 will be restricted to 1.5 percent, inclusive of the new hirings necessary in the special categories.

The new wage increase in 1987 is to apply only to National Government employees. The authorities are determined that the new wage adjustments not be automatically applied to the Government corporations where average compensation levels are above those of the National Government and where a program of structural reform is being formulated.

5. Monetary policy

The major focus of the discussions of monetary policy was the appropriate rate of expansion in monetary aggregates that would accommodate the economic recovery without rekindling inflation. Precision in this area has been complicated by the experience of the last several years, when both the velocity of broad money (M3) as well as the ratio of currency to deposits departed significantly from their longer-term trends. Factors contributing to these shifts were the period of high inflation and interest rates, the protracted recession that affected most severely the more monetized sector of the economy (especially urban-based manufacturing and construction), and the weakness of parts of the financial system. 1/ The demand for M3 was also affected by the increased availability of alternative financial assets, notably short-term bills issued by the Treasury and the Central Bank.

The 1987 financial program has been designed to accommodate real GNP growth of 6.5 percent and inflation of 5 percent during the year. The targeted growth of 15 percent in M3 assumes that the decline in the velocity of M3 that began in the second half of 1986 will continue in 1987, reflecting the anticipated recovery of the monetized sectors and the lagged impact of the decline in inflation and interest rates; however, velocity is still projected to remain above the level of the early 1980s (Chart 2). Consistent with this, end-period base money has been targeted to grow by 11 percent over end-1986 (equivalent to 14 percent growth over the 10-day test period average at end-1986) (Table 11). The base money projection assumes that the currency-deposit ratio will decline from its (seasonally-adjusted) peak of January-February 1987, when it reached over 24 percent in the wake of renewed political uncertainties. However, the ratio is expected to remain relatively high (around 22 percent, on a seasonally-adjusted basis) throughout 1987, in the light of the lower opportunity cost of holding currency associated with lower interest rates. Limits on base money expansion have been specified for end-June, end-September, and end-December 1987 (Section VI). In addition, it is proposed that the end-March 1987 ceiling on base money be modified to increase the ceiling from ₱ 50.8 billion to ₱ 51.8 billion (about 2 percent), in the light of the higher demand for currency.

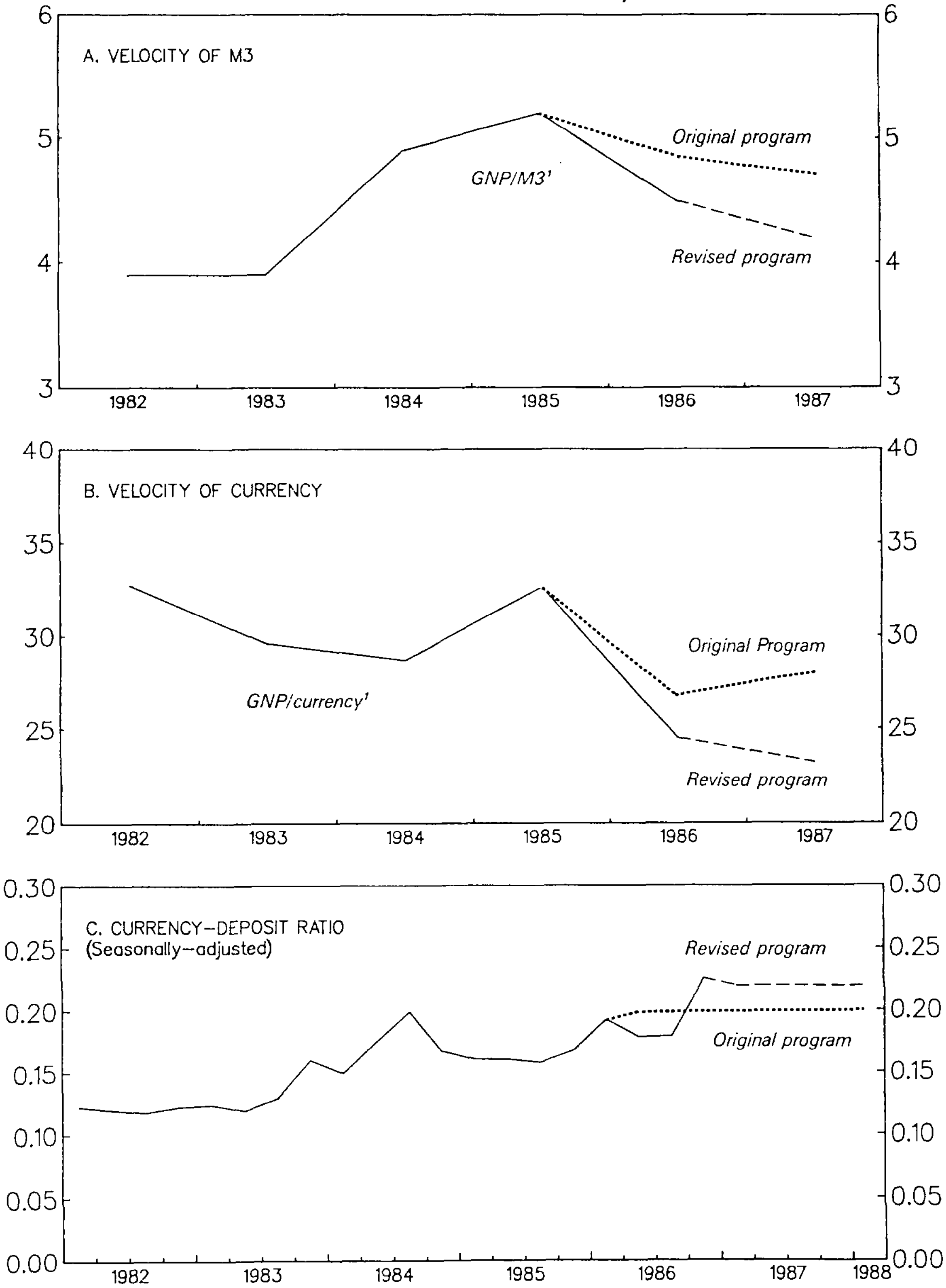
The authorities are aware that there is more than the usual degree of uncertainty about the behavioral relationships underlying the monetary targets in the financial program. In their Memorandum on Economic Policies, they have expressed the intention to keep velocity and currency-deposit relationships under close review and to hold base money growth below the targeted level if it becomes evident that a greater-than-anticipated shift back from currency to deposits is taking place. The program continues to contain flexibility for the targeted growth in base money to be raised (by about 3-4 percentage points), provided the difference arises from an even stronger recovery in real

1/ Some of these issues were discussed in more detail in Annex II of SM/86/259, Supplement 1 (10/2/86).

CHART 2

PHILIPPINES

INDICATORS OF VELOCITY OF CIRCULATION AND CURRENCY–DEPOSIT RATIOS, 1982–88



Sources: Data provided by the Philippine authorities; and Fund staff estimates.

[1] GNP divided by the average of the end–of–period money stocks in each of the four quarters of the corresponding year.

Table 11. Philippines: Reserve Money Program, 1985-88 1/

	1985	1986				1987					1988
	Dec.	Sept.		Dec.		March		June	Sept.	Dec.	March
		Prog.	Act.	Prog.	Act.	Prog.	Rev.	Ceilings			Rev. indic.
Base money	44.3	45.2	44.3	51.0	54.9	50.8	51.8	53.0	54.0	61.0	60.8
(12 month change in percent) 2/	5	17	15	11	24	9	11	24	22	11	20
Less: Reserve eligible securities	5.4	4.9	4.8	4.9	4.9	4.9	4.7	4.7	4.7	4.7	4.7
Less: Reserve deficiency	0.9	0.7	0.0	0.7	0.0	0.7	1.0	1.0	1.0	1.0	1.0
Reserve money	38.0	39.6	39.5	45.4	50.0	45.2	46.1	47.3	48.3	55.3	55.1
Net international reserves of the monetary authority	-33.1	-21.7	-23.2	-16.3	-16.4	-14.0	-13.0	-9.4	-5.6	0.6	0.6
Medium- and long-term foreign liabilities 3/	-47.0	-60.3	-61.6	-67.3	-70.4	-66.7	-70.6	-70.2	-70.5	-71.0	-71.0
Net domestic assets	118.1	121.6	124.3	129.0	136.8	125.9	129.7	127.0	124.5	125.8	125.5
Credit to the public sector	20.9	20.0	17.7	21.9	12.8	22.5	-14.3	-21.8	-24.5	-22.8	-22.1
Of which: National Government (net)	(16.3)	(15.3)	(12.7)	(17.3)	(8.7)	(17.9)	(-18.4)	(-25.9)	(-28.6)	(-26.9)	(-26.9)
Assistance to financial institutions	13.7	13.9	13.8	13.9	13.7	13.9	13.6	13.6	13.6	13.6	13.6
Regular rediscounting	8.3	8.9	7.4	9.3	6.9	9.5	7.1	7.5	7.9	8.3	8.0
Central Bank securities	-32.2	-50.6	-46.6	-56.8	-29.9	-63.8	-15.8	-17.5	-23.6	-30.4	-34.8
Other items (net) 4/	107.4	129.4	132.0	140.7	133.3	143.8	139.1	146.0	151.0	157.1	160.8
Of which: Accumulated central bank interest payments	35.7	50.8	48.9	56.8	54.3	60.8	57.8	61.7	66.1	70.6	74.3

Sources: Data provided by the Philippine authorities; staff estimates; and EBS/86/222.

1/ Foreign assets and liabilities converted into pesos at a constant exchange rate of ₱ 18.002 per US$.

2/ Growth rates refer to end of period data; therefore they differ from program targets given in Table 2, which refer to the 10-day test period.

3/ Includes liabilities assumed under debt restructuring agreements.

4/ Includes peso counterpart deposits related to the Central Bank's assumption of foreign liabilities under debt restructuring agreements.

money demand reflected in an accumulation of net international reserves beyond the program floors.

The authorities have begun a major shift in the conduct of open market operations, involving a reorientation from sales of the Central Bank's own bills toward increased sales of Treasury Bills (and a corresponding increase in government deposits with the Central Bank). This change is in line with the longer-run structural objective of shifting to the Treasury the burden of Central Bank liabilities arising out of quasi-fiscal operations; by itself, however, it does not imply any change in the claims of the broadly defined public sector on private sector resources. 1/

After taking account of the projected improvement in the net foreign assets position, the targeted liquidity growth would be consistent with a 19 percent increase in gross private credit during 1987, reversing several years of decline (Table 12). This increase in credit availability to the private sector will be essential support for the anticipated recovery.

Both deposit and loan interest rates have already declined more sharply than anticipated. The authorities intend to pursue a further reduction in lending rates by reducing the costs of financial intermediation. Reserve requirements have already been reduced by a further percentage point (to 21 percent for short- and medium-term deposits and to 5 percent for longer-term deposits). The authorities are also committed to the abolition of the gross receipts tax on banking institutions that has, for long, been identified as a major contributor to the relatively high costs of financial intermediation in the Philippines. The abolition is timed for January 1, 1988, at the same time as the Value-Added Tax (VAT) is introduced. The authorities are also seeking to make other changes in the regulation of banking institutions that may be contributing to the high intermediation costs.

IV. Structural Reforms: Progress and Policies

Structural reforms are an essential part of the program, necessary to create an environment for the sustained recovery of private investment and activity. Notwithstanding delays in implementing some parts of the structural reforms, substantial progress has been made in this area,

1/ The switch from Central Bank securities to Treasury securities as the primary instrument of open-market operations would only affect the growth of gross private sector credit shown in the monetary survey if the proportions of each type of security held by the banking system differed significantly; in practice, the bulk of both Treasury and Central Bank bills are held outside banks.

Table 12. Philippines: Monetary Survey, 1985-88 1/

(In billions of pesos; end of period)

	1985	1986				1987					1988
	Dec.	Sept.		Dec.		March		June	Sept.	Dec.	March
		Prog.	Act.	Prog.	Act.	Prog.	Rev.	Prog.	Prog.	Prog.	Indic.
Total liquidity	150.5	155.9	151.1	171.8	168.0	178.0	177.3	181.0	184.7	196.3	203.9
M3 2/	132.9	135.4	129.4	150.6	149.8	155.5	154.8	158.0	161.2	172.3	177.2
(12-month change in percent)	10	10	5	13	13	19	18	24	25	15	14
Other liabilities	17.6	20.5	21.7	21.2	18.2	22.5	22.5	23.0	23.5	24.0	26.7
Net foreign assets	-115.4	-107.0	-110.5	-108.4	-109.6	-101.8	-103.2	-98.7	-95.1	-88.7	-79.8
Net international reserves	-63.4	-43.3	-46.7	-37.7	-37.2	-31.6	-30.6	-26.5	-22.6	-15.7	-6.8
Medium- and long-term foreign liabilities	-46.9	-60.2	-61.5	-67.2	-70.4	-66.7	-70.6	-70.2	-70.5	-71.0	-71.0
Net nonmonetary liabilities	-5.1	-3.5	-2.2	-3.5	-2.0	-3.5	-2.0	-2.0	-2.0	-2.0	-2.0
Net domestic assets	265.8	262.9	261.6	280.2	277.6	279.8	280.5	279.7	279.8	285.0	283.7
Public sector credit	35.2	37.0	27.9	39.0	29.2	40.0	6.8	1.1	-2.4	-0.9	-0.2
Credit to National Government (net)	17.7	...	10.9	21.4	13.1	...	-9.4	-15.1	-18.0	-17.1	-17.1
Monitored corporations	8.2	...	6.8	...	6.9	...	7.0	7.0	6.4	7.0	7.7
Other government entities	9.3	...	10.2	...	9.2	...	9.2	9.2	9.2	9.2	9.2
Private sector credit	122.6	121.9	114.8	131.9	115.0	133.8	128.3	132.8	138.9	136.3	130.3
Other items (net) 3/	108.0	104.0	119.0	109.3	133.4	106.0	146.1	144.4	142.7	149.6	153.6
Of which:											
Central Bank security issues outside the banking system	-18.1	-33.1	-29.8	-36.6	-17.8	-41.1	-10.3	-11.7	-17.0	-22.9	-22.9

Source: Data provided by the Philippine authorities, EBS/86/222, and staff estimates.

1/ Foreign assets and liabilities are converted into pesos at a constant exchange rate of P18.002 per U.S. dollar.
2/ M3 includes currency, time and demand deposits, and various deposit substitutes.
3/ Includes net impact of accumulated Central Bank interest payments (Table 10).

and additional policies have been described in the Government's new Memorandum on Economic Policies, to ensure that the momentum of structural reform will continue during 1987.

A review of the public investment program is contained in Annex V. Details of the structural changes adopted and proposed in the area of trade policies were provided in Section III.2.b. Other aspects of structural policies are discussed in this section.

1. Tax reform

The new Memorandum on Economic Policies specifies implementation dates for remaining elements of the 1986 reform package, delayed from last year. It is envisaged that the totality of the tax reform package will be in place by mid-year. Annex II contains a review of the progress in implementing the tax reform package.

Beyond this package, the next major reform measure concerns the planned introduction of a VAT in 1988. The substantial planning necessary for the successful introduction of the VAT is being conducted in close collaboration with the Fund. Thus, two technical assistance missions visited Manila between November 1986-February 1987 and made recommendations regarding the design of VAT and essential features of its administration. A detailed timetable has been drawn up for the preparatory work, including the enactment of the VAT law and regulations. Close adherence to this timetable, including an early announcement (planned for April 1987) of the appropriate Executive Orders, will be essential if the target implementation date of January 1, 1988 is to be successfully met.

2. Public nonfinancial corporations

A major reform of the public nonfinancial sector has been specified in the Memorandum on Economic Policies and is expected to be approved by Cabinet and the President by mid-year. The most important components of the program include: (i) the privatization of 125 of 291 government corporations with the retention of only 37 in their present form; the remainder would be abolished or consolidated; (ii) a major reform of the power sector involving consolidation of the regulatory structure, a phased withdrawal of power subsidies, a new tariff structure based on long-run marginal cost principles, and freedom of entry to the private sector for power generation; and (iii) further progress towards divesting the National Food Authority (NFA) of all activities other than the price stabilization of rice and corn. Specific and detailed components of this reform will be monitored closely by the World Bank as part of its proposed Public Corporate Sector Rationalization Project which will support a program of divestiture of nonfinancial government corporations and improvements in the management and operation of those corporations remaining in the public sector.

The reform also includes macro measures that make explicit traditionally-implicit subsidies and achieve transparency of public sector operations through the levy of an interest charge on national government net lending, the declaration of dividends, the phased settlement of a complex web of arrears, and the elimination of fiscal exemptions and their absorption over time by changes to price policy and improvements in efficiency.

The Government has already embarked upon a major exercise aimed at identifying and settling the existing large payments arrears of the nonfinancial corporations both among themselves and to other public and private entities. It is estimated that at end-1986, total arrears between the 14 major corporations totaled ₱ 5.1 billion and that outstanding arrears between the corporations and the National Government totaled ₱ 0.7 billion.

The reform of the public nonfinancial sector will also involve the rationalization and reduction in size of the public sector labor force. Important steps have already been taken in the NFA with the sale or closure of virtually all of its 154 retail outlets (KADIWA stores) and the consequent reduction in its labor force.

3. Government financial institutions (GFIs)

Reform of the GFIs, formulated by the Government in collaboration with the World Bank under its Economic Recovery Loan, constitutes an integral part of the overall effort to ensure viability of the financial system and improve efficiency of resource use. To this end, important measures are underway to restructure initially the two principal GFIs, the PNB and the DBP, which jointly account for close to half of total banking system assets. The next stage will entail the formulation of reform programs for the smaller institutions, 1/ facing less severe problems. In addition, sales of the six government-acquired banks, to be fully divested by October 1988, have been initiated, with one transaction (sale of 40 percent equity to a foreign buyer) completed and two others approved.

The basic principles of the GFI reforms are contained in a statement of the Monetary Board, as well as policy statements of the PNB and the DBP (with supporting revised charters), all of which became effective in December 1986. The government's policy intent, as detailed in these documents, is to: (i) reduce the share of government banks in the banking system to 25 percent in the coming years; (ii) avoid establishment of new government banks and require existing government banks to achieve and maintain financial viability; (iii) not allow government guarantees on liabilities of these banks, nor government equity infusion to cover losses; (iv) place government banks at par with private banks

1/ These include the Land Bank of the Philippines and Philguarantee.

with regard to tax and credit privileges; (v) subject government banks to annual audit by external private auditors; (vi) restrict public deposits held with government banks, and not permit specific credit programs directed by the Government to be funded from the resources of these banks; and (vii) develop a system of enhanced performance monitoring.

With these broader objectives in view, detailed rehabilitation programs have been drawn up for PNB and DBP. The programs entail major organizational and financial restructurings to be carried out in stages over the next few years. For the PNB, the fundamental objective is to restore financial viability within a two-year period, at the end of which privatization of the bank would be initiated through public offering of stock. In the case of DBP, the plan is to modify the volume of operations, focusing lending activity on agriculture, small-/medium-scale industry, and housing. Expanded lending in other areas is foreseen only after a three-year rehabilitation period during which financial soundness has been established.

For both the DBP and the PNB, the cost reduction programs to be undertaken involve sizable reductions in branch networks and overall staffing, the latter to be achieved largely through voluntary attrition under early retirement schemes. Notable progress has already been made on both fronts. PNB has embarked on a more ambitious staff reduction program than earlier envisaged and has closed a number of overseas offices. DBP has affected a major initial reduction in staffing, to be followed by a reorganization of its existing branches into a network of regional development banks which will eventually be privatized.

As part of the reform program, non-performing assets of the PNB and DBP have been transferred to the newly established Asset Privatization Trust (APT), with a commensurate amount of specified liabilities assumed by the National Government. The book value of assets transferred total ₱ 108 billion (approximately 70 percent of total assets), of which ₱ 61 billion represents transfers from the DBP and ₱ 47 billion those from the PNB. The APT, which will have a lifetime of five years, is expected to sell these assets to the private sector, although their market value is likely to be only a small fraction of their book value. The proceeds of these sales will accrue to the National Government. This financial restructuring is expected to eliminate the need of these institutions for Central Bank assistance beyond normal rediscount facilities.

Finally, plans for the institutional strengthening of both PNB and DBP have been drawn up and are supported by the World Bank. The plans cover strengthening of credit policies, legal procedures, financial controls and management, accounting practices, and personnel management. Technical assistance is being provided by the World Bank to support these rehabilitation efforts. The responsibility for the overall performance monitoring and evaluation of PNB and DBP has been placed with an interministerial committee, under the auspices of the Ministry of Finance.

The performance criterion on Central Bank credit to the PNB is not considered necessary, because the reform precludes special access to Central Bank resources, and has now been abolished.

4. Agricultural policies

The changes in trading and marketing practices in the sugar and coconut sectors have already begun to have an effect. The farmgate prices have strengthened, attributable in major part to the lifting of monopoly elements in domestic and external trade that was a key focus of the reform. In the case of coconut products in particular, the abolition of the export tax together with the freeing of the export trade in copra has strengthened competitive forces and, correspondingly, raised producer prices. There has already been significant diversification in the sources of coconut oil exports, with the entry of substantially increased numbers of traders and millers into the export trade than was the case when exports were channeled through a domestic monopoly.

Progress is also being made in other aspects of the envisaged reform of the sugar and coconut sectors, although there have been delays in completing the reform of the regulatory structure of the two sectors. The attachment of the sugar and coconut bodies to the Ministry of Agriculture, as envisaged in the reform, was delayed until January 1987, but has now been promulgated. The formal abolition of the restriction on new investments in coconut milling capacity has also been delayed but the restriction is expected to be lifted shortly. The audit of levy funds of the previous administration has been completed and investments determined to have been funded from the levy have been sequestered pending their eventual sale to the private sector.

Among other agricultural policies, accelerated land reform has been adopted as a major instrument of economic and social progress. The medium-term land reform program has three components: (i) the completion of the reform of about 0.8 million hectares of tenanted rice and corn land; (ii) the extension of the reform to a further 0.9 million hectares of public-owned or foreclosed land; and (iii) the identification of the next stage of land reform in other agricultural areas. The financing need of the program arises from the cost of land transfer and the development of crop financing and extension services for the affected areas. The authorities have sought foreign financing from bilateral and multilateral sources and expect the domestic costs, at least initially, to be met largely out of the sale proceeds of sequestered and other assets not presently earmarked for National Government revenues.

V. Medium-Term Projections

The medium-term outlook presented at the time of the 1986 Article IV consultation and the request for a stand-by arrangement has been reviewed in light of the delay in the recovery of economic activity and changes in the external environment, including terms of trade developments, slightly lower international interest rates, and altered aid prospects (Tables 13-15). These revisions have not significantly altered the essential elements of the medium term.

The external current deficit is expected to rise gradually over the medium term (Chart 3), remaining within 3 percent of GNP, broadly in line with the earlier set of projections. The financing requirement for the 1988-92 period has been calculated on the basis of: (i) scheduled amortization payments, including those of the banking system; (ii) assumptions regarding new voluntary lending from official creditors (estimated at about \$1 billion annually, the bulk of which remains presently unidentified); and (iii) gross official reserves being maintained at about three months of import and service payments. This results in an average financing gap of about \$2.4 billion annually, of which about \$1.7 billion could be met by reschedulings. The residual financing gap, an average of \$0.7 billion annually, will need to be filled by new concerted or spontaneous lending. The total new financing (apart from rescheduling) to be arranged during the medium term is, however, double this amount (\$1.4 billion annually or about \$7 billion in aggregate) if the unidentified component of assumed new voluntary lending from official creditors (included in the capital account of the balance of payments) is added to the residual gap. It is expected that a growing share of this new financing need, which is higher in the latter years of the period, will be covered by a resumption of spontaneous lending that should accompany a strengthening economy.

With the additional financing projected, external debt rises to \$34 billion by the end of 1992. As a percent of GNP, however, it falls sharply from a peak of 95 percent in 1986 to 67 percent by 1992 (Table 16). After taking account of reschedulings (possibly within the context of a MYRA), 1/ including of principal amounts previously rescheduled by commercial banks, the burden of servicing external debt also falls from 33 percent of exports of goods and services to 26 percent over this period.

The authorities have prepared an alternative set of medium-term projections that assumes sustained 6.5 percent overall GDP growth and, correspondingly, more vigorous export and import growth than assumed by

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1/ The authorities are presently discussing the terms of such a rescheduling with an Advisory Group representing the commercial bank creditors. A report on the status of these discussions will be made to Directors prior to the Executive Board discussion of this paper.

CHART 3

PHILIPPINES

BALANCE OF PAYMENTS, 1983–92

(Billions of dollars)

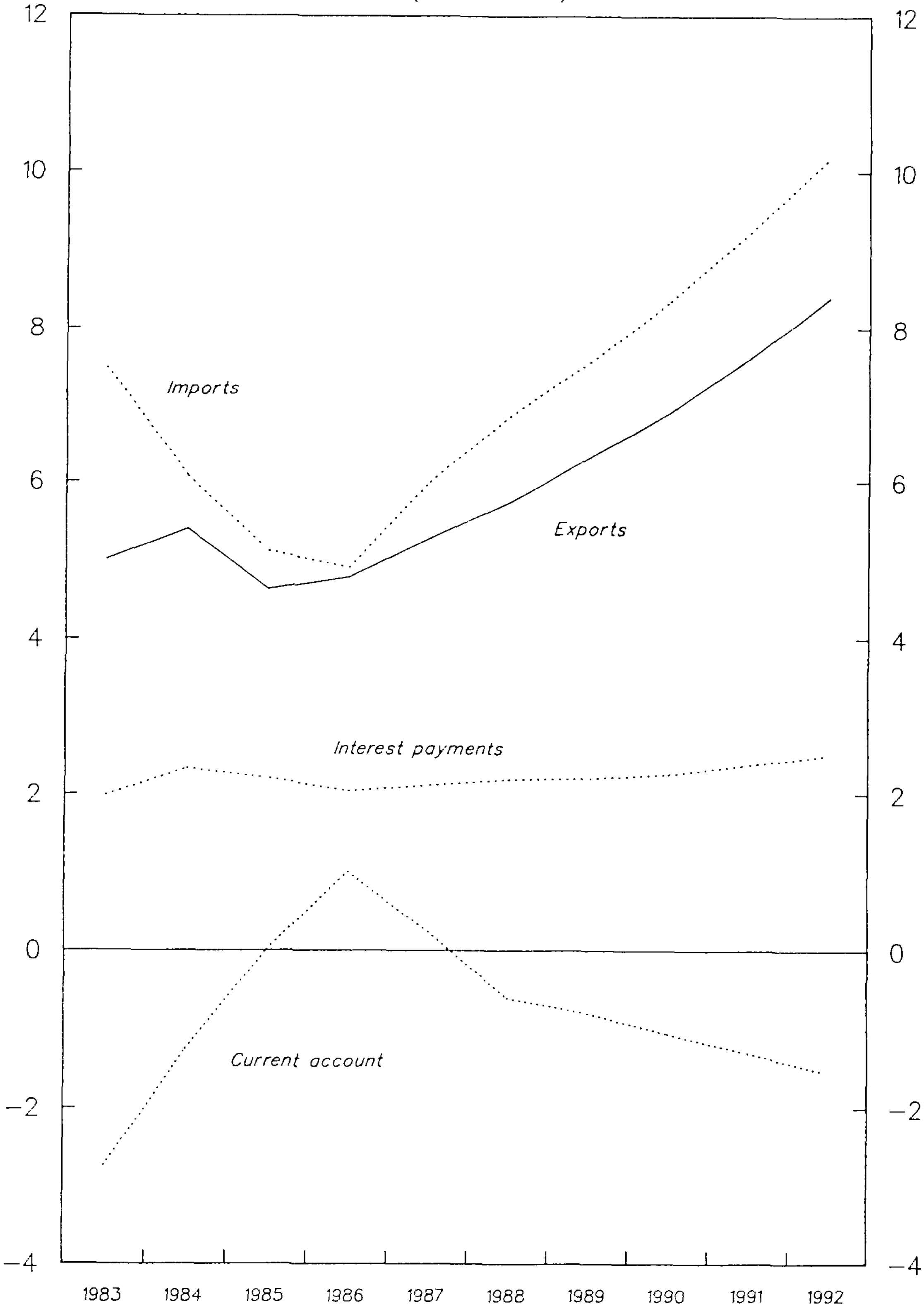

Table 13. Philippines: Balance of Payments, 1985-1992 1/

(In millions of U.S. dollars)

	1985	1986 Est.	Projections 1987	1988	1989	1990	1991	1992
Trade balance	-0.5	-0.1	-0.7	-1.1	-1.2	-1.4	-1.6	-1.8
Exports, f.o.b.	4.6	4.8	5.3	5.7	6.3	6.9	7.6	8.4
Imports, f.o.b.	-5.1	-4.9	-6.0	-6.9	-7.6	-8.4	-9.2	-10.2
Of which: non-oil	(-3.8)	(-4.1)	(-5.1)	(-5.8)	(-6.5)	(-7.2)	(-8.0)	(-8.9)
(Percentage change)	(-16.6)	(7.7)	(22.7)	(14.7)	(11.1)	(11.1)	(11.1)	(11.1)
Services and transfers (net)	0.5	1.1	1.0	0.5	0.4	0.4	0.3	0.2
Of which: interest payments	(-2.2)	(-2.0)	(-2.1)	(-2.2)	(-2.2)	(-2.3)	(-2.4)	(-2.5)
Current account	--	1.0	0.2	-0.6	-0.8	-1.1	-1.3	-1.6
(as percent of GNP)	(--)	(3.3)	(0.7)	(-1.7)	(-2.1)	(-2.5)	(-2.8)	(-3.0)
Capital account	-0.7	-1.4	-0.6	-0.1	-0.2	-0.5	-0.4	-0.5
Medium- and long-term loans	-0.8	-0.8	-0.8	-0.7	-0.6	-1.0	-1.1	-1.1
Inflows	0.7	0.9	1.2	1.2	1.3	1.3	1.3	1.3
Of which: new voluntary 2/	(0.2)	(0.2)	(0.8)	(0.8)	(0.9)	(1.0)	(1.1)	(1.2)
Outflows	-1.5	-1.7	-2.0	-1.9	-1.9	-2.3	-2.4	-2.4
Other	0.1	-0.6	0.2	0.6	0.4	0.5	0.6	0.6
Overall balance	-0.7	-0.4	-0.4	-0.7	-1.0	-1.5	-1.8	-2.1
Finance	0.7	0.4	0.4	0.7	1.0	1.5	1.8	2.1
Net international reserves (- increase) 3/	-2.8	-1.2	-1.2	-1.6	-0.4	-1.0	-1.0	-1.0
Gross reserves (- increase)	-0.3	-1.4	-1.1	-0.2	--	-0.3	-0.3	-0.5
Liabilities	-2.5	0.1	-0.1	-1.4	-0.4	-0.7	-0.7	-0.5
Use of Fund credit (net)	0.2	--	-0.1	-0.1	-0.2	-0.3	-0.2	-0.1
Purchases	0.3	0.3	0.2	--	--	--	--	--
Repurchases	-0.2	-0.3	-0.3	-0.1	-0.2	-0.3	-0.2	-0.1
Other	-2.7	0.1	--	-1.3 4/	-0.2	-0.4	-0.4	-0.4
Financing gap 5/	3.5	1.6	1.6	2.4	1.4	2.5	2.7	3.0
Exceptional finance 5/	3.5	1.6	0.6	2.4	1.4	1.7	1.6	1.5
Rescheduling	3.1	1.1	0.6	2.4	1.4	1.7	1.6	1.5
Paris Club	0.7	0.4	0.6	...	...	...	...	...
Commercial banks	2.4	0.7	--	...	...	...	...	...
Concerted bank lending	0.4	0.5	--	--	--	--	--	--
Residual exceptional finance 5/	--	--	0.9	--	--	0.8	1.1	1.5
Memorandum items:								
Finance to be arranged 6/	--	--	0.9	0.4	0.5	1.5	2.0	2.6
Gross official reserves	1.1	2.5	3.4	3.4	3.3	3.6	3.8	4.3
(months of imports of goods and services)	1.6	3.1	3.8	3.5	3.1	3.1	3.0	3.0

Sources: Philippine authorities; and staff estimates.

1/ Partials may not add up due to rounding.
2/ Projections for 1988 onward include new voluntary lending, mainly from multilateral and bilateral creditors, that is not yet identified.
3/ Change in net international reserves of the banking system (including in 1985 the reduction in external arrears).
4/ Includes $1 billion amortization of banking system liabilities arising from the 1985-86 rescheduling with commercial banks.
5/ The 1987 gap is expected to be covered by a rescheduling of principal maturities due to foreign banks. For future years, the financing gap has been split between rescheduling and residual exceptional finance. This breakdown is based on the assumption of completion of the ongoing rescheduling discussions with commercial banks and some further rescheduling with Paris Club creditors.
6/ Includes the portion of new voluntary lending that is not yet identified and residual exceptional finance.

Table 14. Philippines: Summary Current Account, 1987-92

(In percent, unless otherwise specified)

	1987		Average 1988-92	
	EBS/86/222	Revised Projection	EBS/86/222	Revised projections
Growth of volume of merchandise trade				
Total exports	4.4	3.1	4.7	6.5
Traditional	-2.8	-6.8	2.7	1.3
Nontraditional	7.5	7.6	5.5	7.6
Non-oil imports 1/	8.8	17.6	5.0	6.0
Crude oil imports (in billions of US$)	0.8	0.9	1.1	1.2
Effect of a US$1/ barrel lowering of oil prices on import bill (in millions of US$)	52	54	60	60
Interest payments (in billions of US$)	2.2	2.1	2.3	2.3
Memorandum items:				
Oil prices (US$/barrel)	15.0	17.4	17.1	20.3
LIBOR	7.5	6.5	7.0	7.0
Commodity prices (in US$/metric tons)				
Sugar	390	393	418	357
Coconut oil	231	366	352	326
Copper metal	1,421	1,385	1,631	1,547
Lumber	192	216	221	244

Sources: Philippine authorities; and staff estimates.

1/ Excluding inputs for garments and electronics exports.
2/ Average of U.S. and free market price.
3/ U.S. price; assumes no exports to free market.

Table 15. Philippines: Balance of Payments--Summary of Revisions, 1/ 1987-92

(In billions of U.S. dollars)

	1987		Average 1988-92	
	EBS/86/222	Revised projection	EBS/86/222	Revised projection
Trade balance	-0.8	-0.7	-1.2	-1.4
Exports	(5.0)	(5.3)	(6.6)	(7.0)
Imports	(-5.8)	(-6.0)	(-7.8)	(-8.4)
Services and transfers	0.4	1.0	0.3	0.4
Of which:				
Interest payments	(-2.1)	(-2.1)	(-2.3)	(-2.3)
Current account	-0.4	0.2	-0.9	-1.1
(as percentage of GNP)	(-1.3)	(0.7)	(-2.2)	(-2.4)
Capital account	-0.1	-0.6	-0.2	-0.3
Direct investment and pipeline loans (net) 2/	-0.8	-1.3	-1.2	-1.3
New voluntary lending	0.7	0.7	1.0	1.0
Overall balance	-0.5	-0.4	-1.1	-1.4
Change in net international reserves of the banking system (- increase)	-0.8	-1.2	-0.9	-1.0
Financing gap 3/	1.3	1.6	2.0	2.4

Sources: Philippine authorities; and staff projections.

1/ Partials may not add up to totals due to rounding.
2/ Pipeline loans are those committed through December 1985; includes short-term capital (net) and monetization of gold.
3/ Amounts from 1987 onward are residual financing gaps derived to maintain gross official reserves at the specified equivalent in months of imports of goods and services.

Table 16. Philippines: External Debt Service Projections, 1985-92

(In billions of U.S. dollars)

	1985	1986	1987	1988	1989	1990	1991	1992
Debt service before rescheduling 1/	4.6	4.2	4.4	5.3	4.4	5.0	5.2	5.1
Principal (excluding IMF)	2.2	1.9	2.0	3.0	2.1	2.5	2.6	2.4
IMF repurchase	0.2	0.3	0.3	0.1	0.2	0.3	0.2	0.1
Interest	2.2	2.0	2.1	2.2	2.2	2.3	2.4	2.5
Of which: IMF charges	0.1	0.1	0.1	0.1	0.1	0.1	-- 2/	-- 2/
Debt service after rescheduling 3/	2.6	2.9	2.9	3.0	3.0	3.3	3.5	3.6
Of which: Principal (excluding IMF)	0.5	0.7	0.7	0.7	0.7	0.8	0.9	1.0
Memorandum items:								
Debt service ratio 4/								
Before rescheduling	56	47	48	54	42	44	42	37
After rescheduling 3/	33	33	31	30	29	29	28	26
External debt outstanding, end of period (as percent of GNP)	82	95	89	82	77	73	69	67
Ratio of interest payments to GNP (percent)	6.9	6.9	6.5	6.1	5.6	5.3	5.1	4.9

Sources: Philippine authorities; and staff projections.

1/ Includes debt service payments in 1987 and beyond on the 1985-86 reschedulings.

2/ Less than $0.1 billion.

3/ Assumes completion of the ongoing rescheduling discussions with commercial banks and some further rescheduling with Paris Club creditors.

4/ In percent of exports of goods and services and private transfers.

the staff. These alternative assumptions result in the current account deficit averaging 2.7 percent of GNP during this period, slightly higher than the staff projection of 2.4 percent of GNP (based on 5 percent GNP growth). With other assumptions underlying the two sets of projections being essentially similar, the higher current deficit is carried over into a slightly higher financing need.

The Philippines' obligations to the Fund constitute a small part of its total external debt obligations. In light of the Philippines' past record in meeting its obligations to the Fund, the maintenance of gross official reserves at a comfortable three months of import and service payments, and the relatively small projected reliance on concerted new money packages, it is not envisaged that the Philippines will encounter any difficulty in making repayments to the Fund over the medium term.

VI. Performance Criteria

Performance criteria for the remaining period of the arrangement will include limits on the PSBR, base money, international reserves, and external indebtedness as summarized in Tables 17 and 18. No performance criterion on Central Bank credit to the PNB is proposed for the remaining period of the arrangement because special access to the Central Bank resources is precluded under the PNB reform. Indicative limits for March 31, 1988 will be established at the time of the second review which is intended to be completed before December 1, 1987 and governs purchases after November 30, 1987. 1/

VII. Staff Appraisal

The strategy of the program was two-fold: through structural policies to create an environment that would stimulate a sustained, non-inflationary recovery of activity and, in the interim, through a strengthened public investment program to provide a limited fiscal stimulus for an early initiation of the recovery. Judged by the standard of achieving this early recovery, the strategy has been less than fully successful. Although there have been the first distinct indications of a turnaround in economic performance, and a strengthening in the external situation, the recovery has yet to approach the strength anticipated in the program.

This is not because of any erosion in the macroeconomic and structural policy framework of the program, which remains essentially intact. Indeed, progress has continued in extending this framework to

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1/ The last purchase under the arrangement is scheduled to take place on or after February 1, 1988.

Table 17. Philippines: Quantitative Limits on Domestic Financial Policies, 1986-87

(In billions of pesos)

	1986	1987				
	Dec 31 Actual	Mar. 31 Ceiling		June 30 Ceiling	Sept. 30 Ceiling	Dec. 31 Ceiling
		Original	Revised			
Monetary base 1/	53.4	50.8	51.8	53.0	54.0	61.0
Public sector borrowing requirement (cumulative from January 1 of the corresponding year)	25.5	5.0	6.8	13.3	17.8	23.9
Central Bank credit to PNB 2/	3.0	3.0	3.0	...	...	...

Source: Based on the discussions with the Philippine authorities.

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

2/ The ceiling to be abolished after March 31, 1987 because of the restructuring of PNB.

Table 18. Philippines: Quantitative Performance Criteria for the External Sector, 1987

	1986	1987			
	Dec. 31 Actual	Mar. 31 Ceiling 1/	June 30 Ceiling	Sep. 30 Ceiling	Dec. 31 Ceiling
External sector					
Net international reserves of the monetary authority (floor)	-964	-778	-521 2/	-309 2/	33 2/
Short-term external debt outstanding	7,212 3/	9,050 3/	7,600	7,600	7,600
Approvals of external borrowing with maturities of 1-12 years	...	1,400	1,000 4/	1,000 4/	1,000 4/
Approvals of external borrowing with maturities of 1-5 years	...	300	200 4/	200 4/	200 4/

Source: Based on the discussions with the Philippine authorities.

1/ The March performance criteria were set at the time of approval of the standby arrangement. The March ceilings on approvals of foreign borrowing refer to cumulative borrowings from July 1, 1986 onward.

2/ Floors for the respective test dates will be adjusted: (1) upward (downward) by the amount by which the cumulative total of new money disbursements after January 1, 1987 on external debt contracted after December 31, 1985 from foreign commercial banks and official sources exceeds (falls short of) $426 million at end-June 1987, $480 million at end-September 1987, and $753 million at end-December 1987; (2) upward (downward) by the amount that the level of deposit liabilities of the Central Bank to foreign commercial banks under the trade facility falls short of (exceeds) $1,788 million at end-June 1987, $1,727 million at end-September 1987, and $1,753 million at end-December 1987; and (3) upward (downward) by the amount that the level of central bank assumed liabilities under Circular 1091 falls short of (exceeds) $ 358 million at end-June 1987, $361 million at end-September 1987, and $374 million at end-December 1987; In addition, the floor will be adjusted upward (downward) by the amount that actual rescheduling falls short of (exceeds) the following amounts: (i) the floors for end-June, September, and December 1987 assume a rescheduling from commercial banks between January 1, 1987 and June 30, 1987 of $438 million, September 30, 1987 of $676 million, December 31, 1987 of $947 million; (ii) the floors for end-June, September, and December 1987 assume a rescheduling of principal and interest by Paris Club creditors between January 1, 1987 and June 30, 1987 of $302 million, September 30, 1987 of $453 million, and December 31, 1987 of $604 million.

3/ The March ceiling on short-term debt includes $1,599 million of non-monetary short-term obligations and monetary reserve liabilities which have been converted to medium- and long-term debt by means of rescheduling. On a comparable basis, the end-December 1986 short-term external debt was $8,811 million.

4/ Cumulative approvals from January 1, 1987 onward of all public and private sector foreign borrowing in the specifed maturities, excluding reserve liabilities of the banking system and concessional loans (i.e., with a grant element of 25 percent or more).

include structural change in areas where policies had not evolved sufficiently at the time of the approval of the arrangement last year. Policies have now been formulated that give credence to the Government's commitment to reshape its role in the financial system, to dramatically alter the nature and extent of its intervention in the economy through the nonfinancial public corporations, and to further the process of import liberalization.

Rather, if the strategy has been less than fully effective, this has reflected, first, the risk inherent in its reliance on a rapid private sector response and, second, difficulties in implementation that have kept the public investment program well below its potential and delayed the announcement and implementation of some of the structural reforms. While the timing and speed of the return of private sector confidence, and with it private investment and growth, cannot be predicted with precision, recent events would suggest that the process is now underway.

In contrast, the other constraint to the effective unfolding of the strategy, that related to the process of implementation, lies directly within the Government's capacity to influence and to redress. In particular, the Government needs to ensure that the various factors that impeded implementation of the public investment program in 1986 are swiftly addressed, that there is no further delay in implementing residual elements of the tax reform program, and that the desired regulatory structure in the sugar and coconut sectors is established as soon as possible.

Beyond this, implementation of the institutional and financial aspects of public sector reform is essential to the credibility of the program. The timetables that have been established for carrying out the reorganization of the public financial institutions and for announcing the modalities of and implementing the reform of the nonfinancial sector should, therefore, be strictly carried out. Equally, it will be essential that the PSBR is reduced in 1988 in line with the program to make room for the private recovery.

The 1987 National Government wage policy seeks to address longstanding distortions in the wage structure as well as to reverse the secular decline in the relative compensation level of National Government employees. It is essential that, pari passu with this wage restructuring, other government initiatives to rationalize public sector employment proceed without delay. Also, that future wage adjustments be linked to such improvements in productivity and do not risk sparking general wage increases that would undermine competitiveness.

Financial policies under the program have been formulated to accommodate the anticipated recovery and to take account of recent behaviorial changes that raised the public's demand for currency and reduced velocity. The authorities need to monitor closely developments in domestic output as well as in the behavioral relationships, and to restrict the growth in the monetary aggregates below the targeted levels if these developments so require.

The medium-term projections point to the current account shifting to a deficit in the range of 2-3 percent with continued reliance on exceptional financing. The need for concerted lending packages in future years will depend on the success with which an improved policy environment and economic recovery trigger the return of spontaneous commercial lending. This scenario requires a substantial improvement in export performance, in the absence of which the economy may well grow at a rate below potential. While an improved export performance depends in part on the state of the world economy, economic policy must give primary importance to the maintenance of an environment that directly supports a recovery and a diversification of exports. In particular, the authorities need to ensure that the structure of price incentives during the medium-term period further strengthens the competitive position of the traded goods sector. This will require continued progress in import liberalization, adherence to established timetables for effecting tariff reform, and a flexible intervention and exchange rate policy.

The staff recommends the waiver and modification contained in the draft decision.

VIII. Proposed Decision

The following draft decision is proposed for approval by the Executive Board:

1. The Philippines have consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for the Philippines (EBS/86/222, Sup. 2, October 28, 1986) and the second paragraph of the letter dated September 18, 1986 from the Minister of Finance and the Governor of the Central Bank of the Philippines, in order to review the progress in implementing the program supported by the stand-by arrangement and establish suitable performance criteria.

2. The letter dated March 10, 1987 from the Minister of Finance and the Governor of the Central Bank with annexed Memorandum on Economic Policy will be attached to the stand-by arrangement and the letter dated September 18, 1986 with annexed memorandum shall be read as supplemented and modified by the letter dated March 10, 1987 with annexed memorandum.

3. Accordingly,

(i) the limit on the public sector borrowing requirement referred to in paragraph 4(a)(i) of the stand-by arrangement shall be as specified in paragraph 7 and Table 2 of the Memorandum on Economic Policy annexed to the letter dated March 10, 1987;

(ii) the limit on base money referred to in paragraph 4(a)(ii) of the stand-by arrangement shall be as specified in paragraph 10 and Table 2 of the same Memorandum;

(iii) the limit on net international reserves of the monetary authority referred to in paragraph 4(a)(iv) of the stand-by arrangement shall be as specified in paragraph 15 and Table 3 of the same Memorandum;

(iv) the limit on the approval of nonconcessional external loans referred to in paragraph 4(b)(i) of the stand-by arrangement shall be as specified in paragraph 18 and Table 3 of the same Memorandum; and

(v) the limit on short-term debt referred to in paragraph 4(b)(ii) of the stand-by arrangement shall be as specified in paragraph 18 and Table 3 of the same Memorandum.

4. The Fund decides that the review contemplated in paragraph 4(c) of the stand-by arrangement is completed and that the Philippines may proceed through June 15, 1987 to make purchases that shall not cause purchases under the arrangement to exceed the equivalent of SDR 58 million, notwithstanding paragraphs 4(a) and (b) of the arrangement.

Philippines - Fund Relations
(As of February 28, 1987)

I. Membership status

(a) Date of Membership: December 27, 1945
(b) Status: Article XIV

A. Financial Relations

(Amounts in millions of SDRs, unless otherwise indicated)

II. *General Department (General Resources Account)*

	Amount (SDR millions)	As percent of quota
(a) Quota:	440.4	100.0
(b) Total Fund holdings of pesos:	1,342.31	304.79
(c) Fund credit:	940.70	213.60
Of which: Credit tranches	266.25	60.46
EFF	24.90	5.65
SFF	115.17	26.15
EAR	216.00	49.05
CFF	318.38	72.29
(d) Reserve tranche position:	38.83	8.82

III. Stand-By and Extended Arrangements

(a) The latest arrangement was approved on October 24, 1986.
Duration: October 24, 1986 through April 23, 1986
Amount: SDR 198 million or 45 percent of quota
Utilization: SDR 23 million
Undrawn balance: SDR 175 million

(b) Previous stand-by and extended arrangements.

Type of Arrangement	Date of Approval	Duration	Amount	Utilization
SBA	05/16/73	1 year	45.00	--
SBA	07/16/74	1 year	38.75	38.75
SBA	05/31/75	1 year	29.06	29.06
EA	04/02/76	3 years	217.00	217.00
SBA	06/11/79	1 year	105.00	91.25
SBA	02/27/80	2 years	410.00	410.00
SBA	02/25/83	1 year	315.00	100.00
SBA	12/14/84	1 1/2 years	615.00	403.00

Philippines--Fund Relations (continued)

(c) Special facilities

Type of special facility	Date of Approval	Amount
CFF	02/25/83	188.50
CFF	10/24/86	224.10

IV. SDR department

(a) Net cumulative allocation:	116.60
(b) Holdings:	10.26
(As percent of net cumulative allocation)	8.80

V. Administered accounts

(a) Trust Fund loans	
(i) Disbursed	151.47
(ii) Outstanding	63.68
(b) SFF Subsidy Account	
(i) Donations to Fund	--
(ii) Loans to Fund	--
(iii) Payments by Fund	45.82

VI. Overdue obligations --

B. Nonfinancial Relations

VI. Exchange rate arrangement: Since October 15, 1984, the exchange rate for the Philippine peso has been determined freely by market forces. On that date, the rate was determined at ₱ 19.95 = $1 representing a depreciation of about 8.1 percent from the rate of ₱ 18.33 = $1 on October 12, 1984. Between mid-December 1984 until mid-1985, the peso broadly appreciated in real effective terms against the U.S. dollar. Since October 15, 1985, the peso has depreciated against the U.S. dollar and has stabilized at around ₱ 20.5 = $1 since February 1987.

VII. Last Article IV Consultation: The 1986 Article IV consultation report (EBS/86/222 and Sup. 1) was discussed by the Executive Board on October 24, 1986 (EBM/86/173). The following decision (Decision No. 8428-(86/173) was adopted:

Philippines--Fund Relations (concluded)

1. The Fund takes this decision relating to the Philippines' exchange measures subject to Article VIII, Section 2(a) and in concluding the 1986 Article XIV consultation with the Philippines, in light of the 1986 Article IV consultation with the Philippines conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund welcomes the maintenance by the Philippines of an exchange system free of restrictions on payments and transfers on current international transactions other than the recently introduced limitation on the remittance of certain dividends, in connection with the debt to equity conversion scheme, as described in the forthcoming report on recent economic developments, which is subject to approval under Article VIII, Section 2(a). The Fund urges the authorities to look into the possibility of achieving their investment aims by means other than those involving an exchange restriction.

VIII. Consultation cycle: The summing up indicated that the next Article IV consultation would be held on the standard 12-month cycle.

VIII. Technical Assistance: Technical missions from the Bureau of Statistics on external debt statistics visited Manila in September 1986 and on general statistics (production, employment, wages) in February 1987. Missions from the Fiscal Affairs Department visited Manila during October-November 1986 and February 1987 to advise on the introduction of the value added tax.

IX. Resident Representative: A Resident Representative has been stationed in Manila since January 1984.

The Tax Reform Package, 1986-87

A comprehensive picture of the status of implementation of individual measures in the tax reform package, together with estimates of their yield in 1986 and 1987, is given in Table 1. During the second half of 1986, delays occurred in issuing some of the Executive Orders implementing parts of the tax reform package, and the promulgation of some of the detailed implementing rules and regulations also took longer than anticipated. By January 1, 1987, however, two thirds of the measures comprising the total package were in effect and, with one exception, the authorities are committed to introducing all remaining measures not later than the middle of 1987. The exception is the politically-sensitive tax amnesty on the repatriation of foreign assets (measure 28) which is under study by the Presidential Commission on Good Government (PCGG). Of the measures to be implemented in 1987, the most important (with targeted date of implementation in parentheses) are: (i) withdrawal of tax and duty incentives (March 15, 1987); (ii) imposition of a minimum 10 percent duty on all imports and adoption of CIF basis (April 15, 1987); and (iii) implementation of BIR incentives scheme (March 15, 1987). In addition, the authorities have already begun a pilot project on adopting the SGS methodology for the valuation of imports, a measure that was not included in the original tax reform package.

The delays in implementation, the weaker economic recovery, and lower-than-projected receipts from higher cigarette excise taxes contributed to a substantial shortfall in the revenue impact of the tax reform in the second half of 1986. The actual increase in receipts attributed to the reform is now estimated at ₱ 2 billion, compared with a program target of ₱ 9 billion. The major shortfalls occurred in the withdrawal of various tax and duty exemptions (measure 24), the adoption of certain administrative reforms (measures 26-30), and the collection from cigarette excises (measure 15). The first two of these were associated primarily with implementation delays, while the shortfall in cigarette excise collections was due mainly to accelerated shipments by producers in the first half of 1986, in anticipation of the tax increases.

The revenue impact of the reform package in 1987 is now estimated at ₱ 15.4 billion (excluding the yield from import liberalization), an increase from the original program estimate of ₱ 13.4 billion. The increase is primarily because of the carryover into 1987 of the once-and-for-all impact from administrative measures that were not introduced in 1986 (measures 29 and 30). The total yield in 1987 from these two measures is now estimated at ₱ 4.4 billion. In addition, the tax amnesty has been extended through March 1987 and the authorities expect this to yield an additional ₱ 0.4 billion in the course of 1987.

Table 1. Philippines: Status of Implementation and Yield of Tax Reform Package, 1986 and 1987

(In millions of pesos)

Measure	Effective date of implementation 1/	Revenue Impact: 1986 Second half Program	Revenue Impact: 1986 Second half Actual	Revenue Impact: 1987 Program	Revenue Impact: 1987 Revised
A. INCOME TAXES					
I. Individual income tax					
1. Partial shift from schedular to global income tax	1 January 1986	2/	2/	2/	2/
2. Apply uniform rate structure of 0-35 percent to business incomes of individuals	1 January 1986	0	0	-527	-643
3. Apply ceilings on selected allowable business deductions	planned for fiscal 1987	0	0	200	0
4. Apply uniform "final" tax of 20 percent on interest and passive incomes, other than dividends to which gradually declining "final" rates will apply	1 August 1986	150	150	300	300
5. Raise personal exemptions to avoid taxing income below "poverty line"	1 January 1986	-182	-182	-410	-494
6. Adopt separate taxation of incomes of married couples	1 January 1986	-200	-200	-600	-671
II. Corporate income tax					
7. Apply uniform rate of 35 percent	1 July 1986	125	125	500	595
8. Apply ceilings on selected allowable deductions	15 April 1987	170	0	684	597
9. Exempt inter-corporate dividends	1 August 1986	-14	-14	-30	-30
B. INDIRECT TAXES					
III. Motor vehicle fees					
10. Rationalize motor vehicle registration fees other than for public transportation	1 January 1987	0	0	2/	2/
IV. Sales tax					
11. Rationalize tax rates to only three levels, 10, 20, and 30 percent	1 August 1986	0	0	0	0
12. Remove all tax exemptions	1 August 1986	0	0	0	0
13. Disallow "deemed" paid taxes as tax credits	1 August 1986	0	0	0	0
14. Phase-out turnover tax and replace with value-added tax in 1988	planned for fiscal 1988	0	0	0	0
V. Excise taxes and duties					
15. Convert all excise taxes to ad valorem rates and increase taxes on:	1 July 1986				
cigarettes		1,816	943	5,220	5,109
beer		278	278	700	723
16. Levy 5-20 percent excise tax on motor vehicles as maximum sales tax rate is lowered to 30 percent	1 August 1986	0	0	0	0
VI. Real property tax					
17. Adjust present (1978-based) taxable values to 1984 values	1 July 1987	0	0	71	71
VII. Travel tax					
18. Exempt contract workers	8 July 1986	-51	-51	-100	-100
VIII. Export duties					
19. Abolish all export duties except on logs	1 July 1986	-358	-358	-700	0
IX. Import duties					
20. Move from HCV to CIF basis of import taxation (except where Customs exercises right to use higher HCV)	1 January 1987 3/	75	0	300	71
21. Impose minimum 10 percent duty on imports zero-rated in the Tariff Code	4 December 1986 3/	80	0	150	113

Table 1. Philippines: Status of Implementation and Yield of Tax Reform Package, 1986 and 1987 (concluded)

(In millions of pesos)

Measure	Effective date of implementation 1/	Revenue Impact: 1986 Second half Program	Revenue Impact: 1986 Second half Actual	Revenue Impact: 1987 Program	Revenue Impact: 1987 Revised
C. MISCELLANEOUS					
22. Rationalize tax rates on gambling activities, e.g., casinos, jai-alai, lotteries, etc.	Executive Orders have been prepared for	2/		2/	2/
23. Integrate casino, tourist and other funds into the General Fund	President's signature	0	0	0	0
D. EXEMPTIONS AND INCENTIVES					
24. Withdraw tax and duty exemptions outside of the BOI system, EPZA and those under international contracts and replace, where necessary, with subsidies	15 March 1987	1,600	0	7,500	3,792
25. Impose uniform franchise tax and withdraw income tax exemptions	1 December 1986	45	0	180	90
Subtotal: Policy reform measures		3,534	691	13,438	9,523
E. TAX ADMINISTRATIVE MEASURES					
26. Tax amnesty on income and other internal revenue taxes	October 1986	1,040	1,010	0	400
27. Tax amnesty on real property tax	26 August 1986	222	222	0	0
28. Tax amnesty on repatriation of foreign assets	Under study	0	0	0	0
29. Compromise agreements on disputed assessments and delinquent accounts	15 October 1986	1,040	67	0	1,042
30. Raise BIR incentives	15 March 1987 4/	3,200	0	0	3,375
31. Adoption of SGS scheme	Fiscal 1987 5/	0	0	0	1,019
Subtotal: One-time administrative measures		5,502	1,299	0	5,836
Total Reform Measures		9,036	1,990	13,438	15,359

Sources: Data provided by the Philippine authorities; and staff estimates.

1/ After the issuances of necessary Executive Orders, and operating rules and regulations. In some cases, because operating rules were delayed, effectivity is retroactive to the listed effective dates.
2/ Unestimated but positive.
3/ Yield calculated as of April 15, 1987.
4/ Will only be triggered when BIR collections exceed certain targeted percentages of GNP.
5/ To be introduced in 1987; not included in original tax reform package.

Philippines: Summary of the Economic Program

1. Objectives of the program

a) A recovery in real GNP growth to 6.5 percent in 1987, to be sustained in 1988; b) containment of inflation within 5 percent; c) the implementation of specific structural reforms in trade, in the public sector, and in agriculture.

2. External policies

a) The current account is projected to remain in surplus (0.7 percent of GNP) in 1987 and to return to the deficit path originally programmed only in 1988; b) debt reschedulings (Paris Club and commercial banks) are expected to meet the financing gap in 1987, while allowing for the further accumulation of official reserves to almost four months of import and service payments; c) over the medium term, a major strengthening of export performance remains a key objective. Accordingly, the exchange system will remain free of administrative impediments, and exchange rate and intervention policy will ensure that the exchange rate develops consistent with medium-term objectives.

3. Domestic policies

a. Public finances. i) The consolidated public sector deficit (inclusive of the Central Bank and the GFIs) is targeted to decline from 5.9 percent of GNP in 1986 to 5.4 percent in 1987 and to 5.1 percent in 1988 through (a) implementation of the remaining elements of the tax reform package; (b) reform of the GFIs and the public nonfinancial sector; and (c) continued safeguards to rule out additional Central Bank losses from new operations. ii) The deficit of the monitored public sector (national government and 14 major corporations) is projected to decline from 4.2 percent of GNP in 1986 to 3.5 percent in 1987 and to 2.6 percent in 1988.

b. Incomes policy. National government expenditures in 1987 incorporate a 24 percent average increase in compensation per employee with the purpose of rationalizing the public sector compensation program, reducing the disparity between public and private sector pay, and arresting the erosion in real wages of public sector employees. Employment in the public sector will be limited to its 1986 level except for increases in certain specialized positions.

c. Monetary program. i) The monetary program provides for growth in broad money of 15 percent, in line with the original program projection, so as to accommodate the 6.5 percent growth objective for 1987. ii) The consistent base money program, which allows for base money growth of 14 percent during 1987, assumes that currency demand will remain relatively high throughout the year. iii) The program continues to incorporate a band for reserve money expansion linked to NIR performance. iv) Structural factors that have raised the cost of financial intermediation are under review in order to reduce the present wide margin between deposit and lending rates.

4. Structural policies

a. Tax reform. A timetable has been established for the implementation of the remaining elements of the tax reform package introduced in 1986. Work toward the introduction of a value added tax on January 1, 1988 is proceeding on schedule.

b. Public nonfinancial corporations. A major reform of the public nonfinancial sector is expected to be approved by mid-1987. The reform involves: (i) the privatization of 125 of 291 government corporations and, of the remainder, retaining only 37 in their present form; (ii) macro measures that make explicit traditionally-implicit subsidies and achieve transparency of public sector operations; (iii) a major reform of the power sector involving consolidation of the regulatory structure, a phased withdrawal of power subsidies, a new tariff structure based on long-run marginal cost principles, and freedom of entry to the private sector for power generation; and (iv) further progress towards divesting the National Food Authority of all activities other than the price stabilization of rice and corn.

c. Public financial institutions. Agreement has been reached with the World Bank to restructure the government financial institutions. A fundamental rehabilitation of the two major government banks has been initiated.

d. Trade liberalization. Further to the measures implemented in 1986, the authorities have announced a schedule (extending through April 30, 1988) for the liberalization of i) all items remaining from the April 30, 1986 list; and ii) items previously scheduled to be liberalized on December 31, 1986 and on June 30, 1987. New tariffs (not to exceed a maximum of 50 percent) have also been announced for items that have been liberalized.

e. Sugar and coconut sectors. Reforms are now essentially in place for both sectors. Pending actions pertain to the coconut sector and include: i) removal of restrictions on milling capacity; ii) formulation of a financing program for rehabilitation; iii) completion of the reorganization of the sector.

5. Performance criteria

Quantitative criteria have been set for end-June, end-September, and end-December 1987 for base money, the public sector borrowing requirement (PSBR), NIR, short-term external debt, and new approvals of external debt in the 1-12 and 1-5 year maturities. A small modification has been made in the end-March 1987 base money ceiling to reflect the stronger-than-programmed currency demand. The end-March 1987 PSBR has also been modified in line with the modestly higher public sector deficit target for 1987. The ceiling on Central Bank lending to the Philippine National Bank has been abolished in view of the restructuring of government financial institutions which rules out special access to Central Bank resources.

The Program for Conversion of Philippine External Debt into Equity Investments

A debt/equity conversion program was introduced in 1986 in recognition that Philippine external debt obligations were being traded in secondary markets and to further exploit investment opportunities in the Philippines. 1/ The program was designed to achieve mainly the following policy objectives: (i) to stimulate long-term equity investments in Philippine enterprises by both foreign investors and Philippine nationals; (ii) to encourage the repatriation of flight capital; (iii) through preferential schedules to provide incentives for investment in designated sectors; and (iv) to reduce the external debt burden of the Philippines.

Eligibility

External debt of Philippine public and private sector borrowers eligible for redemption in connection with a conversion transaction are distinguished by four categories: (i) all principal maturities covered by a restructuring agreement; (ii) all principal maturities owed by public sector borrowers falling due on or before January 1, 1987 (other than debt covered by a restructuring agreement or the 1985 new money agreement) and all principal maturities owed by private sector borrowers 2/; (iii) credits, including deposits, maintained with the Central Bank covered by the Trade Facility; and (iv) other obligations which may be approved for conversion by the Monetary Board. Groups of investors may act through a nominee or agent in filing applications for approval, although the investor in whose name the investment is registered at the time of closing will be subject to the restrictions set for liquidation.

Under the program, there are two schedules governing the investment of the peso proceeds of convertible debt redeemed in connection with a conversion transaction. The preferred investments, specified under Schedule 2, fall under the following areas of economic activity:

1/ On August 4, 1986, Central Bank Circular 1111 was issued to implement Executive Order 32 dated July 24, 1986 which authorized the Central Bank to establish a debt equity conversion program in the Philippines.

2/ In this case, eligibility for conversion requires also that credit instruments relating to such debt permit the prepayment or repayment of the obligation through the delivery of an equivalent amount of pesos. Furthermore, external debt which becomes the subject of a restructuring agreement entered into after the date of Circular 1111 could qualify as convertible debt only if the discharge of the debt in pesos would be consistent with the terms of such restructuring agreement.

1. The production, manufacturing, or processing of export products from the Philippines, provided that the Philippine enterprise involved qualifies as an export-oriented firm.

2. The rendering of technical, professional or other services outside the Philippines which are paid for in foreign currency.

3. The production of agricultural goods and the provision of related services, regardless of whether the agricultural produce is intended for export from the Philippines.

4. The provision of health care services or the construction of health care facilities in the Philippines.

5. The construction or maintenance of low- and middle-income housing projects in the Philippines.

6. The construction or maintenance of education facilities in the Philippines.

7. To the extent not otherwise covered by one of the items listed above, an investment in a Philippine enterprise that engages principally in an activity listed in the investment priorities plan in effect at the time.

Investments in less preferred areas of economic activity, not covered in the above items, are designated as Schedule 3 investments.

Conversion procedures

An investor wishing to engage in a conversion transaction submits the application and supporting materials to the Debt Restructuring Office of the Central Bank; and is required to pay a non-refundable application fee of P 10,000 (equivalent to about US$500). The investor is notified of the decision of the Monetary Board regarding the application for conversion within 45 days of the date of application. In case of a negative decision, the investor may resubmit the application or a modified version of it at a subsequent date. Upon approval of the Monetary Board, the investor normally has 60 days from date of approval to close the transaction; otherwise, the approval is automatically withdrawn. During the 60-day period, the investor has to make satisfactory arrangements with the holders of one or more items of convertible debt that would permit the presentation of such debt to the obligor in return for an equivalent amount of pesos (to be determined at the exchange rate prevailing at the time of redemption). The obligor's consent shall be required for any peso redemption of convertible debt. On the closing date for a conversion transaction, the convertible debt shall then be deemed to be redenominated into its peso equivalent. If an obligor that is a government owned or controlled corporation does not have sufficient pesos from its own resources to redeem an item of its convertible debt, it may request peso credit for this purpose from the Central Bank to be advanced through a Philippine commercial bank.

The investor pays the Central Bank a peso conversion fee amounting to 5 percent for investment in preferred sectors and 10 percent for investment in less preferred sectors. For investments in less preferred sectors, the investor must fulfill the "fresh money requirement" by paying 10 percent of the total investment in pesos purchased with foreign exchange from the Central Bank or an authorized Philippine commercial bank at prevailing exchange rates.

In preferred sectors, capital repatriation is not allowed within the first 3 years after the investment is made. During the 4th through the 8th years, not more than 20 percent of the capital portion of the investment may be repaid in each year. Dividends in respect of these investments may be paid out of profits made. In the less preferred sectors, capital repatriation is not allowed within the first 5 years after the investment is made; in each of the 6th through the 10th years, not more than 20 percent of the capital portion of the investment may be repaid. Dividend payments are allowed only after the fourth year.

Criteria for approval

In order to achieve the objectives of the conversion program, the authorities carefully evaluate the quality of conversion requests according to certain approval criteria. A primary objective of the program is to ensure that conversion results in incremental investment and economic activity in the Philippines. To achieve this objective, conversion must increase the availability of foreign savings to the economy, rather than divert via the conversion program resources that would otherwise have been available. Therefore, one criterion of approval is that conversion not be used merely to buy the claims of current stockholders to existing assets, to boost working capital of an existing firm, or to pay obligations of existing firms. Exceptions are permitted if conversion is to be used in part to pay obligations to the Government or its agencies or to purchase assets from the Government under the privatization program. Attention is also paid, in the approval process, to the monetary impact of conversion, an issue which has arisen in connection with the conversion of central bank debt instruments.

At present a review of the conversion program is being undertaken. The objectives of the review are to widen the sectoral coverage for potential investments under the program, hasten the approval process, and when deemed necessary, re-evaluate fee percentages and liberalize remittance privileges.

Experience under the conversion program

Since the inception of the program through February 24, 1987, the Central Bank has received 79 applications for conversion, with a total value of US$277 million. Sixty-eight applications amounting to US$129 million were in the preferred sectors (under Schedule 2), while the remaining 11 applications totaling US$147 million, were in less preferred sectors.

The Central Bank has approved 32 conversion transactions valued at US$56.1 million, which involve investment in Philippine enterprises categorized as follows:

Schedule 2 (Preferred)	No.	Amount (US$ million)
1. Export producers	16	28.6
2. Agricultural producers	4	5.2
3. Health Care/Educational Facilities	2	3.0
4. Educational Facilities	2	0.4
5. Investment Priorities Plan listed activities	2	7.1
Sub-total	26	44.3

Schedule 3 (Less Preferred)	No.	Amount (US$ million)
1. Hotels	3	2.0
2. Pharmaceuticals (compounding/packaging)	1	1.5
Sub-total	4	3.5
TOTAL	30	47.9

In addition to these 30 approvals, the classification of 2 approved applications, involving housing projects and totalling US$8.2 million, has not been determined. The Central Bank has disapproved 8 applications for conversion amounting to US$153.4 million on the grounds that the criteria for approval were not satisfied. Another 39 applications amounting to US$67 million remained pending.

Twenty-two applications with a total value of US$39.6 million, including the 4 approved Schedule 3 applications, have been closed. 1/ The debt instruments that were prepaid in these cases were central bank obligations amounting to US$36.6 million, and private sector debt amounting to US$3.0 million.

1/ Redemption or closing with respect to a conversion transaction refers to the act of presenting an item of eligible debt to the borrower for prepayment in Philippine currency. Investors are required to place those peso proceeds arising from the redemption which are not for immediate utilization in the investment project in nonassignable central bank bills; maturities are based on the schedule of utilization of the peso proceeds in the investment project. Proof to support the need for the disbursement of pesos is required prior to closing date. The Central Bank may undertake an inspection of the plant facilities or the proposed project site before an evaluation of the application is submitted to the Monetary Board and may review books or accounts and other documents to ensure that said peso proceeds had in fact been utilized for the purposes represented in the application.

PHILIPPINES

PUBLIC INVESTMENT PROGRAM FOR 1987

WORLD BANK ASSESSMENT

1. The total public investment program for 1987 is designed to provide essential infrastructure for sustaining economic recovery, and essential levels of social services. The program totals ₱ 33.7 billion, or 5 percent of GNP, which is consistent with the Government's Medium-Term Investment Program for 1987-92, which calls for an investment level of 5-6 percent of GNP. The substantial increase in the investment program for the national government of about 37 percent represents largely carry-over activities from 1986. The investment program of ₱ 9 billion for the Ministry of Public Works and Highways, and the Ministry of Transportation and Communications (MPWH/MOTC) is expected to be well within their present implementation capacity as measured against an achieved investment program of ₱ 8.5 billion during the difficult transition period of 1986.

PUBLIC SECTOR INVESTMENT
(In billion pesos)

	1986		1987
	Program	Actual	Budget
National Government, total	15.9	13.2	17.9
Infrastructure	7.9	8.5	9.0
Other capital outlays	6.8	3.5	7.5
Allotment to local governments	1.2	1.2	1.4
Major corporations	13.6	7.9	15.1
Other corporations	0.4	0.4	0.7
Total	29.9	21.5	33.7
Percent of GNP	4.7	3.6	5.0

2. The investment program for the major 14 public corporations calls for a substantial increase over the implemented program in 1986. The large increase represents mainly ongoing projects in the National Power Corporation's (NPC) program which had to be carried over from 1986 as a result of financing constraints caused by debt service obligations for the nuclear power plant. Since the national government has assumed all financial obligations of the nuclear power plant, NPC is expected to be able to fully complete its investment program for 1987. Another large part of the increase in the investment program for the major corporations represents high priority rehabilitation investments in the water supply sector.

3. The 1987 budget also calls for a substantial increase by 49 percent for operating and maintenance (O&M) expenditures in economic and social services. This increase redresses the past trend of declining levels of O&M expenditures which have fallen by 50 percent since 1982 despite an expanding capital base. The current increase would meet the Government's target of restoring O&M expenditures for economic and social services to the real 1982 level, as a minimum.

O&M EXPENDITURES - ECONOMIC AND SOCIAL SERVICES
(In million pesos)

	Actual		Budget
	1982	1986	1987
Nominal	6,676	8,848	13,914
1982 prices	6,676	4,455	6,676

4. In our judgment, the effective implementation of the above program is necessary to ensure the continuation of the process of economic recovery. Implementation constraints in 1986 were substantially the result of the transition process in government and budget cuts imposed to offset revenue shortfalls and did not reflect actual physical implementation constraints. With substantial unemployment and a depressed construction industry, an expanded investment program is easily within existing implementation capacity of the country, and will be an essential part of the economic recovery during 1987.

World Bank Activity in the Philippines 1/

1. World Bank lending in 1985-87

Between January 1, 1985-March 30, 1987, the Bank approved six loans to the Philippines, totaling $565 million in new commitments (Table 1). Included in this is $300 million for an Economic Recovery Loan approved in March 1987. This loan supports important reforms of the government financial institutions, public investment program, trade liberalization, and tax reform, and is expected to be disbursed in three equal tranches over the next three years.

Table 1. Loan Approval in 1985-87

(In millions of U.S. dollars)

	Project	Amount	Date
1.	Telecommunications Technical assistance	4.0	02/19/85
2.	Agricultural credit	100.0	06/06/85
3.	Manila Water Distribution	69.0	01/23/86
4.	Rural Roads II	82.0	06/26/86
5.	Economic Recovery Loan	300.0	03/17/87
6.	Economic Recovery Technical Assistance Project	10.0	03/17/87
	Total	565.0	

As of March 30, 1987, there were 42 Bank-assisted projects under implementation in the Philippines. The disbursements for these projects during 1986 totaled $197 million. The Bank estimates a level of disbursements of $240 million during 1987.

The Bank has a number of projects under consideration for possible approval in 1987 or 1988. These include a Public Corporation Reform Project, which will support a program of divestiture of nonfinancial government corporations and improvements in the management and operation of those corporations remaining in the public sector. In agriculture, a proposed loan for sugarland rehabilitation will help improve

1/ Prepared by World Bank staff.

productivity and diversification in sugar producing areas, while a loan for irrigation operations support will help define a realistic program for rehabilitation and maintenance of the irrigation system. Other lending operations being developed include a provincial ports project, a small-scale industry development project, and land classification titling technical assistance project.

The Bank is engaged in a number of economic and sector studies which will help define development issues and future lending strategies in key sectors. An industrial sector mission visited Manila in August 1986 and its report will shortly be discussed with the Government. It will focus on several important issues, including industrial restructuring, technological change and the nature of the industrial incentive system. An agricultural sector mission visited Manila in March 1987 to review the Government's current strategy in this sector and the possible role of Bank assistance. A special economic mission was recently in Manila to review the implementation of the public investment program, and public corporation cost recovery and pricing issues. A proposed Financial Sector Study is presently being discussed with the Government.

Disbursement figures for all World Bank loans for 1985, 1986, and 1987 are summarized in the following Table.

Table 2. IBRD/IDA Estimated Disbursements, 1985-87

(In millions of U.S. dollars)

	1985	1986	1987 Est.
Disbursements on projects, pipeline 10/83	180	115	140
Disbursements on new loans made after 10/83	67	82	220
Total	247	197	360

2. Outstanding financial relations

a. IBRD/IDA lending operations
(as of January 31, 1987)

	Commitments IBRD	Commitments IDA	Undisbursed
	(In millions of U.S. dollars)		
Sixty-five loans and four credits disbursed	2,276.2	53.7	
Present commitments	1,690.0	62.0	841.8
Total	3,966.2	115.7	841.8
Repayments	760.3	1.2	
Debt outstanding	3,174.8	114.5	

b. IFC investments
(As of September 30, 1986)

Total gross commitments	187.8
less: repaid, sold or cancelled	-39.4
Total commitments held by IFC	148.4

Recent economic and sector reports:

The Philippines: A Framework for Economic Recovery, November 5, 1986, No. 6350-PH.

Sugarlands Diversification Study: May 30, 1986, 6942-PH.

Technical assistance:

The IBRD has provided technical assistance to the Philippines through its standard lending operations. A recently approved Economic Recovery Technical Assistance Project for $10 million will support the rehabilitation programs of the two largest government financial institutions, finance a study of the government social security insurance systems, and provide consultants, training and equipment to improve selected operations within the Central Bank, the Ministry of Finance, and Asset Privatization Trust.

Aid Consultative Group:	The Consultative Group, under the chairmanship of the Bank, met in January 1987 in Paris. A meeting of the subcommittee of the Consultative Group is tentatively scheduled to meet in Tokyo later this year. A Country Economic Memorandum on the Philippines, prepared by the World Bank was distributed and discussed at this meeting.

Basic Data

Philippines

Area:	300,000 sq. km
Population (1986):	56.5 million
Annual rate of population growth (1978-86):	2.7 percent
Gross national product (1986):	$29.6 billion (P 604 billion)
GNP per capita (1986):	$524

	1984	1985	1986	1987 Proj.
	(Changes in percent)			
GNP and prices				
Real GNP	-6.8	-3.8	0.1	6.5
Of which: Agriculture	2.4	3.2	3.3	3.5
Manufacturing	-7.2	-7.6	1.2	7.0
Nominal GNP	39.0	13.0	1.6	11.8
Implicit GNP deflator	49.1	17.5	1.5	5.0
Consumer price index (end period)	50.8	5.7	-0.3	5.0
Nominal GNP (in billions of pesos)	526.3	594.6	604.0	675.0
National Government				
Total revenue	24.8	21.1	14.8	26.4
Total expenditure and net lending	25.8	20.1	33.8	12.6
Current expenditure	24.3	25.9	22.8	39.4
Capital expenditure	-5.8	3.1	30.7	35.6
Money and credit 1/				
Net domestic assets 2/	2.5	13.5	4.4	2.7
Domestic credit	-8.2	-4.5	-8.6	-6.1
Public sector credit 3/	10.5	19.3	-17.0	...
Private sector credit	-11.5	-9.7	-6.2	18.5
Total liquidity	6.9	8.1	11.6	16.8
M3	7.3	9.7	12.7	15.0
Base money	11.6	8.3	23.9	11.1
Interest rate (average 90-day money market rate)	36.3	12.6	8.1	7-8
External sector				
Exports, f.o.b. (in dollar terms)	7.7	-14.1	3.3	10.4
Imports, f.o.b. (in dollar terms)	-18.9	-15.8	-4.1	22.4
Exchange rate (period average)				
Nominal effective	-29.5	-7.3	-21.3	...
Real effective	-1.1	9.5	-22.0	...
P/$ nominal exchange rate (level)	16.7	18.6	20.4	20.8
	(In millions of U.S. dollars)			
Balance of payments				
Exports, f.o.b.	5,391	4,629	4,780	5,275
Imports, f.o.b.	-6,070	-5,111	-4,900	-6,000
Services and transfers, net	-589	490	1,108	958
Current account balance	-1,268	8	988	233
Overall balance 4/	-200	-722	-388	-352
External debt (end period)				
Total (including IMF)	25,418	26,252	28,186	28,910
Medium- and long-term 5/	15,082	16,564	21,635	22,389
Short-term nonmonetary	4,285	3,591	2,790	2,845
Short-term monetary	5,207	4,982	2,588	2,598
IMF	844	1,115	1,173	1,078
Debt service (as a ratio to exports of goods and services) 6/	35	33	33	31
Gross official reserves (end period)				
(In months of imports of goods and services)	1.3	1.6	3.1	3.8
	(In percent of GNP)			
Gross domestic investment	19.2	16.2	14.0	17.4
Gross national saving	15.2	16.2	17.3	18.1
National Government revenue	10.8	11.6	13.1	14.8
National Government expenditure and net lending	12.7	13.5	17.8	17.9
National Government deficit	-1.9	-1.9	-4.7	-3.1
M3 (end-period)	23.0	22.3	24.8	25.5
Exports	17.1	14.5	16.1	16.3
Imports	19.3	16.0	16.6	18.5
Current account deficit	-4.0	—	3.3	0.7
Overall surplus/deficit (-)	-0.6	-2.3	-1.3	-1.1
External debt	80.6	82.0	95.2	89.2

Sources: Data provided by the Philippine authorities; IMF, International Financial Statistics; and staff estimates.

1/ End-period; may differ from growth rates calculated using 10-day average test periods.
2/ Net domestic assets with net foreign assets converted into pesos at a constant exchange rate of P 18 per $1.
3/ Gross public sector credit.
4/ Before rescheduling and concerted lending.
5/ Includes IMF Trust Fund.
6/ After rescheduling, and including IMF.