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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/172

10:00 a.m., October 24, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	Mawakani Samba
C. H. Dallara	
J. de Groote	
	T. Alhaimus
H. Fujino	M. Sugita
	B. Goos
Huang F.	Jiang H.
	Jaafar A.
A. Kafka	H. A. Arias
	J. Hospedales, Temporary
	M. Foot
	I. Puro, Temporary
	G. D. Hodgson, Temporary
	A. Abdallah
	M. A. Weitz, Temporary
	J. E. Suraisry
	J. E. Rodríguez, Temporary
	S. de Forges
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
	O. Kabbaj
	A. S. Jayawardena
S. Zecchini	

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

IBRD: A. Sonmez, East Asia and Pacific Regional Office. Asian Department: P. R. Narvekar, Director; H. Neiss, Deputy Director; M. J. Fetherston, D. J. Goldsbrough, E. Gurgen, A. Singh. Exchange and Trade Relations Department: S. J. Anjaria, E. H. Brau, D. Burton, D. A. Lipton, P. Neuhaus. Fiscal Affairs Department: V. Tanzi, Director; V. P. Gandhi. IMF Institute: V. Quinbo, Participant. Legal Department: P. L. Francotte. Research Department: N. M. Kaibni, H. C. Kim, E. C. Meldau-Womack, M. A. Wattleworth. Western Hemisphere Department: O. Roncesvalles. Bureau of Statistics: H. Flinch. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. Ouanes, G. Pineau, D. C. Templeman, N. Toé, Song G. Assistants to Executive Directors: G. P. Alzetta, O. S.-M. Bethel, V. Govindarajan, L. Hubloue, Z. b. Ismail, S. King, K.-H. Kleine, T. Morita, R. Msadek, G. Schurr, B. Tamami, Wang X., Yang W.

1. REPORT BY MANAGING DIRECTOR

At Seminar 86/10 (10/20/86), the Chairman remarked that during his visit to Turkey on October 14-18, 1986, he had met with the Prime Minister, the Deputy Prime Minister, the Governor of the Central Bank, and officials of the Treasury for discussions on the economic and financial situation in Turkey and the world.

There had been a remarkable transformation of the economy since his last visit to Turkey in 1973, the Chairman went on. Striking changes had occurred in agriculture, industry and urban development. The results of Turkey's decision to open up its economy and to eliminate a number of traditional barriers to development were clearly evident. Turkey's overall performance was most encouraging. Of course, some problems remained, and the staff was about to begin the 1986 Article IV consultation discussions with the authorities. It would be most interesting to see how economic policy would be shaped in the coming months.

In Paris, he had also met with officials in the French Treasury and the Bank of France, the Chairman said. In addition, he had had an exchange of views with the Minister of Finance of Brazil, who had been visiting France, that had been very productive in terms of the collaboration between the Fund and Brazil.

2. EXECUTIVE DIRECTOR

At Seminar 86/10 (10/20/86), the Chairman welcomed Mr. McCormack as Alternate Executive Director.

3. PHILIPPINES - 1986 ARTICLE IV CONSULTATION; REQUEST FOR STAND-BY ARRANGEMENT; AND USE OF FUND RESOURCES - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1986 Article IV consultation with the Philippines and request for a stand-by arrangement in an amount equivalent to SDR 198 million (EBS/86/222, 9/22/86; Cor. 1, 10/17/86; Cor. 2, 10/22/86; and Sup. 1, 10/23/86), together with a staff paper on a request for a drawing under the decision on the compensatory financing of export fluctuations (EBS/86/223, 9/22/86, and Sup. 1, 10/2/86). They also had before them a report on recent economic developments in the Philippines (SM/86/249, 10/1/86; Cor. 1, 10/17/86; and Sup. 1, 10/2/86).

Mr. Rye made the following statement:

> On behalf of my Phillipine authorities, I would like to thank the staff and management once again on the occasion of this consultation. As usual, it was handled with total professionalism yet with understanding also. We believe that the staff papers offer a thorough and accurate picture and a fair assessment of the country's economic situation. They leave me with very little to add.

One point I do wish to make is that, while fully appreciative of the staff's candid assessment of the economy, and of their sympathetic view of the approach to economic policy in the Philippines, my authorities nevertheless are more sanguine--or perhaps ambitious--about the medium- and longer-term possibilities. They recognize that the staff's relative conservatism about the near and medium term constitutes a firm ground for, and check on, their own bolder vision for the years beyond. My authorities appreciate the shorter term constraints which realistic adjustment imposes, and they remain firm in their commitment to the program as outlined in EBS/86/222. But their high expectations about the medium and longer term derive from their sense of a mandate to translate into actuality the maximum growth potential inherent in a properly adjusted economy.

It should be clear that my Philippine authorities intend: (1) to adhere strictly to the adjustment program under the stand-by arrangement; (2) to seek no new money from the commercial banks for the entire period of the stand-by arrangement; and (3) to negotiate expeditiously with the commercial banks with a view to concluding, soon after talks begin on October 28, 1986, a multiyear restructuring agreement, the resolution of the balance in the amount of $350 million of the 1985 money facility, and the extension in the availability and maturity of trade facility commitments. My authorities have expressed a determination to ensure that nothing distracts these negotiations from their proper focus.

It is also important to clarify, at this point, the question of the contingency fund referred to in Supplement 1 to the staff report. First, it should be stressed that, as regards the program period, the contingency fund is only being explored with multilateral agencies, and then only so far as it may be able to contribute toward the country's attainment of program targets. As I pointed out, the authorities are firmly committed to the adjustment program and do not intend to deviate from its objectives. Second, it should be stressed that discussions between my authorities and the World Bank on the contingency fund are at this stage only exploratory.

The Philippine authorities agree fully with the staff that "many of the economic conditions essential for a recovery are in place."

First, the major gains realized under the previous stand-by arrangement have been maintained. Inflation has been kept under control. The exchange rate has been stabilized and reflects a genuine market rate. The flow of flight capital has been halted. The current account deficit has been eliminated. Further, the country's reserves have been built up to a level twice that at end-February 1986, largely through increased foreign exchange and gold sales from the private sector to the Central Bank. The goals of external adjustment have been achieved sufficiently to allow some growth orientation in the immediate term.

Second, renewed and even intensified efforts at structural reform have been undertaken. A wide-ranging overhaul of the tax system has been set in motion. It should improve equity by lightening the tax burden of the lower income sectors of the population, by broadening and simplifying income tax rates, and by removing disincentives to growth and efficiency. Tax collection has been significantly improved. From a ₱ 1.1 billion shortfall in the first quarter of 1986, collection has increased to an amount of ₱ 912 million above that in the same period of 1985. The ban on copra exports has been lifted, and the monopolies in coconut, sugar, meat, grains, and fertilizer have been dismantled. Free trading has been restored in all these commodities.

Along with the institution of mechanisms for the disposition of the nonperforming assets of the Philippine National Bank and the Development Bank of the Philippines, these institutions are being restructured and reduced in size and in operational scope. Their special deposit and guarantee privileges have been removed and safeguards have been established that will ensure the viability of their operations on a competitive and commercial basis. The government nonfinancial corporations, for their part, are currently being scrutinized in preparation for basic reforms. End-1986 remains the target for implementation.

The trade liberalization program has been resumed. At this very moment, the Philippines Monetary Board is discussing, and is expected to approve (as previously undertaken--see page 34 of EBS/86/222) tariff adjustments for items liberalized on September 30, 1986, and the new schedule for the liberalization of the remaining items from the original end-1985 program. Promulgation will follow very soon thereafter. These developments should improve the cost competitiveness of domestic producers by allowing free access to lower-cost or higher-quality imports.

Third, the external environment has not been entirely inhospitable. To be sure, commodity prices for the country's major traditional exports remain depressed. Oil costs, however, have been kept down, and international interest rates have continued to decline even in real terms. Last, but by no means least, support from the international community, bilateral as well as multilateral, has exceeded expectations.

My Philippine authorities wish to emphasize that the underlying thrust of their efforts continues to be to motivate the private sector to resume its traditional role as the prime mover of the economy. They are convinced that the key to the realization of their medium-term expectations--ambitious as these may appear at the moment--will be the strength of private investment response to the challenges and opportunities which the recovery program provides.

At the beginning of this statement, I spoke of the promise of growth of a properly adjusted economy. My authorities remain convinced of this. They are nevertheless aware that, particularly for the more heavily indebted developing countries, the fruition of this promise is impossible of attainment without steadfast support from the international community, as much technical as financial. On both counts the Fund has always been in the vanguard and the catalyst. For this, my Philippine authorities are grateful, and they look forward keenly to Directors' comments and counsel.

Mr. Rye added that the discussions of the Philippines Monetary Board, to which he had referred, had in fact led to the approval of the trade liberalization program, which was expected to be promulgated on October 27, 1986. The tariff adjustments had also been approved.

Mr. Fujino made the following statement:

I heartily welcome this opportunity of discussing the Fund-supported new economic program, which has been formulated after a somewhat prolonged discussion between the authorities and the Fund following the establishment of a new Government in February 1986. The new Government has already introduced corrective fiscal measures to reverse the slippage that occurred in early 1986. The excess liquidity that accompanied the fiscal expansion has also been reabsorbed by the open market operations of the Central Bank. In the area of structural reform, the authorities have formulated a comprehensive tax reform, import liberalization, and a basic reform of the sugar and coconut sectors, all of which will be fully implemented. On the basis of these achievements, the Philippine Government is embarking on a new economic program of stable growth which aims at both financial stabilization and structural reform. The program, which has been drawn up after close consultation with the Fund and the World Bank and represents the fruits of collaboration between the two staffs, will provide a solid foundation for the reconstruction and development of the economy.

At the time of the second review under the previous Fund-supported program in December 1985, I expressed my expectation that the economy would return to an orderly recovery path based on stringent demand management and comprehensive structural reform. Although some waivers were requested, especially in the area of fiscal performance, the deficit on the external current account had been reduced, the rate of inflation had sharply declined, and the stance of financial policy appeared to be firm. However, these achievements were not without cost and economic activity had continued to plunge. The decline in real GNP in two years amounted to over 10 percent. Efforts of fiscal consolidation had resulted in reduced public investment, and operational and maintenance expenditures were an impediment to curtailing current expenditures. In spite of the recent improvement in the economic environment, a recovery in economic activity has been slow to materialize.

Under the circumstances, the new program rightly attaches high priority to the recovery in economic growth, which will be realized by a substantial initial increase in public investment, and in operational and maintenance expenditures. Indeed, the reduction in public investment in such key areas as transport and communication had aggravated the already deteriorated condition of the public infrastructural network. The reordering of the investment program and the increase of expenditures in essential areas are the first steps in preparing the grounds for sustained growth.

The endorsement by the World Bank staff of the restructured investment program is a welcome indication that the new orientation of the program is appropriate. At the same time, the authorities are firmly committed to addressing structural problems that have inhibited competition and efficiency in various markets. Beyond 1986, however, the maintenance of economic growth hinges upon the extent to which a withdrawal of fiscal stimulus will be offset by a recovery of private investment in response to renewed investor confidence abroad and at home. As Mr. Rye's candid statement emphasizes, the key to the program's success will be the strength of private investment response to the challenge and opportunity the program provides. The successful implementation of the economic program will constitute a precondition for the recovery of investors' confidence, although one should not be overly optimistic, given the current external economic environment and political uncertainties.

According to Supplement 1 to the staff report, the authorities are contemplating a request to multilateral agencies for the establishment of a growth contingency fund. We will have to await the details of this possible proposal to make a proper evaluation. There is further clarification in Mr. Rye's statement, but any additional information from the staff would be appreciated. In view of the sharp decline of real GNP in the past two years, and uncertainties relating especially to external conditions, I basically understand the need to place emphasis on economic growth. However, caution will certainly be needed to guard against a likely relaxation of adjustment efforts and the risk of further accumulation of external debt. These outcomes would weaken the basis of the economy and are likely to harm the growth potential in the longer run. Also, it must be emphasized that economic growth will not fail to follow a successful implementation of the present economic program by restoring confidence.

The medium-term balance of payments projections show that there will still remain a substantial financial gap up to 1991, to be closed by official and private reschedulings and possibly by concerted lending by banks. The implications are that Fund involvement, whether as a catalyst or as a provider of enhanced surveillance, might be required beyond the present program. I therefore find the proposed mix of a stand-by arrangement and compensatory financing appropriate. In my view the staff has successfully demonstrated that all the conditions for the use of the compensatory financing facility have been met.

On specific issues, and referring first to fiscal policy, I note with satisfaction the adoption of a tax package in June 1986 which aims at broadening the tax base, improving revenue elasticity and resource allocation, and providing incentives for growth. In the last stage of the previous program, the implementation of the tax reform had weakened or been partly reversed by the restoration of fiscal exemptions. The new package is a significant step toward a basic and structural reform of the tax system. The switch to a global income tax and the lowering of top marginal tax rates, the withdrawal of tax exemptions, and the expected implementation of a value-added tax in 1988 would all work, together with the streamlined tax administration, to increase the resiliency of the tax system and also lead to the enhanced resource mobilization required for balance of payments adjustment.

On the expenditure side, I believe that a substantial increase in capital outlays and maintenance expenditures is justified. If absorptive constraints emerge with respect to these expenditures, the authorities are committed not to reallocate the excess funds other than for the purpose of reducing the fiscal deficit. I would like to urge the authorities to adhere strictly to this commitment. While the combined deficit of nonfinancial corporations has been reduced considerably since 1983, it still constitutes a major claim on the resources of the National Government. Moreover, the pervasiveness of the parastatal sector has had the effect of stifling private initiatives in some important economic activities. I welcome the authorities' intention to decide on the rationalization and privatization of 214 corporations by the end of 1986, and I look forward to examining the progress made at the first program review. The rapid increase in the deficit of government financial institutions in 1985 was really alarming. The fact that about 60-70 percent of the portfolios of these institutions are now nonperforming illustrates well the slack decision-making process of lending in the past. As the staff notes, this reform was scheduled and due under the previous program and therefore has to be implemented, with advice from the World Bank, as soon as possible.

Second, on monetary policy, I find the monetary target that has been set for 1986 in order to reduce the excessively high real interest rate and provide some stimulus to economic activity to be broadly appropriate. In 1987, however, if the recovery in economic activity does not materialize, the envisaged monetary expansion may turn out to be excessive, thus fueling inflation. Perhaps we will have to re-examine this issue on the occasion of the first program review on the basis of the actual data available at that time.

Third, on external policies, although the current account attained a small surplus in 1985, export performance has been generally poor. Exports declined by 12 percent in dollar value compared with the previous year.

The medium-term prospects of the economy will depend importantly on the favorable performance of exports. As the supplement to the background paper points out, the growth prospects of current export items are limited, and major diversification into nontraditional export items that are labor intensive and natural resource based would be required. Exchange rate policy will have to play an important role in the expansion of exports as well as in the diversification of traded goods. The real appreciation of the peso in late 1984 and early 1985, which led to a delay in the balance of payments adjustment, may have been attributable partly to the depressed economic conditions and the high domestic interest rate. However, a delay in the implementation of trade liberalization also contributed to an inadequate adjustment in the exchange rate. I welcome the authorities' intention to expedite trade liberalization, which is also clearly outlined in Mr. Rye's statement, and, in the meantime, to avoid a real appreciation of the peso through the achievement of quarterly net international reserve floors. The scheme for the conversion of debt into equity, which was introduced in August 1986, could serve as a useful instrument in external debt management; I should like to urge the authorities to modify flexibly the terms and conditions of this scheme in accordance with the responses they will receive from potential investors.

Fourth and finally, on structural policies, I have already discussed the individual measures of structural reform under separate headings, and I would like to limit myself here to one important aspect, the reform of the sugar and coconut sectors. Annex VI of the staff report explains the major points of the reform programs now being implemented. For sugar, the essential element is a smooth and flexible adaptation of production to world market conditions. For the coconut sector, a new productivity program directed at small holders is a welcome development. In view of the weight of that sector in terms of the number of people engaged in coconut production, the success of the medium-term replanting program is very important.

In order to enhance the long-term growth potential, it is essential to provide an economic and institutional framework which would promote competition and utilize private initiatives. The structural reform has to aim at establishing such a framework. The restoration of investors' confidence at home and abroad, which will constitute a precondition for sustaining economic growth beyond 1986, will also hinge critically on the progress of the structural reform. Bold and far-reaching design and swift implementation are called for.

The external financing requirement is projected to average about $2 billion annually up to 1991. Although the need for exceptional financing may be of a rather limited magnitude, the successful implementation of the new economic program and timely fulfillment of external obligations is an essential condition to secure the necessary support of the international community. When these conditions are sufficiently met, my authorities would be ready to cooperate positively together with other creditors.

In conclusion, while there were temporary setbacks arising from political uncertainties in early 1986, the broad framework of the growth-oriented stabilization policy has been adhered to. On this basis, the authorities are now embarking on a strong, new program which aims at a recovery of economic growth and at furthering a comprehensive structural reform. I warmly welcome this initiative and support the proposed decisions.

Mr. Hodgson made the following statement:

The past few years have been traumatic for the Philippines, with the economy experiencing a sharp decline in real output, and with a dramatic political change. In many respects, the new Government now stands at a crossroads and, accordingly, we are asked today to consider a comprehensive set of economic policies aimed at promoting rapid economic recovery.

At present, a number of positive factors set the stage for economic recovery. Inflation is low, the external accounts are more or less in balance, there is no apparent need for further exceptional financing in the form of concerted new money, and the prospect now even exists for a quick recovery in real growth. Nonetheless, the economy remains fragile, with a narrow economic base badly in need of restructuring. If the authorities are to begin to meet their expectations for growth, they must move ahead with resolution in tackling deep-seated structural problems. In that regard, I welcome the fundamental role being played by the World Bank in supporting structural reforms and growth-oriented policies in the Philippines.

The bulk of my remarks will focus on the ambitious structural reforms. If the authorities' overall economic package is to be credible, the structural measures must be quickly and fully implemented, though the difficulties associated with their introduction should not be underestimated. We agree with the general thrust of the structural reforms, since they are indispensable for fostering the improved environment of competitive markets and private investment that is essential for long-term growth in the Philippines. It is very encouraging that reforms with respect to the tax structure, the public sector investment program, import liberalization, and some agricultural policies are more or less already in place. In particular, I would commend the Philippine authorities for their rapid action on tax reform which reflects past staff recommendations and far exceeds previous efforts at tax reform.

As for the public expenditure program, the aim of raising real capital outlays above 1985 levels is a correct one. We support the emphasis placed on expenditures required for maintenance of the capital stock and for meeting the social infrastucture needs of the population. However, I would like to underline the concerns raised by the World Bank on the absorptive constraints in the Philippine economy. In particular, the comments on page 59 of Annex IV to the staff report suggest that a more gradual increase in the investment budget might actually lead to a more efficient allocation of investment funds. Perhaps the staff or the World Bank representative could comment on this issue, since efficient use of investment resources is at least as important as a rapid increase in public investment.

On import liberalization, we would urge the authorities to continue their efforts to complete the program and to liberalize items outside the present schedule. The expected shift of the external current account into a small surplus during 1986 creates an excellent opportunity for easing restrictions on imports, an opportunity which should not be missed.

Another area of concern to us is the continuing need to rationalize the operation of government financial institutions and the parastatals. Indeed, if there has been any single failing in previous Fund-supported programs in the Philippines, it has been the failure to adequately address the inefficient operation of public financial and nonfinancial institutions, their impact upon the fiscal balance, and, perhaps most important, the monopoly power which they have exercised. We shall be looking for quick implementation of the reform plan for government financial institutions. The authorities have also announced plans to rationalize and improve their control over the parastatals; they recently announced their intention to sell off 163 state-owned enterprises, beginning early in 1987. The authorities can quickly enhance the credibility of their adjustment program by displaying concrete results in this area. In that respect, the replacement of tax incentives for the parastatals by explicit budgetary subsidies is a positive first step.

In past programs, there has been a distinct lack of progress in reforming the agricultural sector. Therefore, the successful implementation of new institutional arrangements in the sugar and coconut sectors, as well as measures affecting other crops, will be a very imortant signal. Some reform of the National Food Authority (NFA) has already been undertaken, and we note that further measures are being considered for rice and corn so as to improve the trading environment. All the reform measures with respect to financial institutions, the parastatals, and the agricultural sector will need to be carefully examined during the program reviews.

Turning to the macroeconomic policy framework, I must express some reservations about the expected pace of recovery and about the fiscal position over time. Growth is projected to rebound from about 1 1/2 percent in 1986 to 6 percent or 7 percent in 1987. However, the positive impact arising from the structural reforms may not be felt as quickly as expected. In the short run, some of the changes may actually increase uncertainty and instability in particular sectors and markets. Investor confidence, both foreign and domestic, has suffered a severe blow because of political uncertainties and the recent recession, and it may take some time for confidence to be adequately restored.

Under the program, the national government deficit is expected to increase to about 4 1/2 percent of GNP in 1986 and then fall to 2 1/2 percent next year. Fiscal policy is expected to provide an initial stimulus through sharp increases in investment outlays and maintenance expenditure, and is then to be withdrawn in 1987 as the locus of growth shifts to the private sector. However, as the World Bank suggests, there may be absorptive capacity constraints for public investment, and a slower rate of investment growth may actually lead to better allocative efficiency. Therefore, if there was a smaller deficit in 1986 due to absorptive constraints being met, and slightly larger deficits in 1987 and beyond due to a pushing back of investment outlays, this should not necessarily be regarded as a negative development.

On specifics, the authorities' caution with respect to revenues arising from the tax reform is justified. It also goes without saying that the Government must steadfastly avoid surges in spending such as occurred during the election period. Good fiscal performance will not only contribute to lower interest rates and allow credit to be shifted toward private investment, but would strongly add to the credibility of the Government and its recovery program.

I am concerned, however, by the statement in Supplement 1 of the staff report, and repeated by Mr. Rye in his otherwise lucid statement, that the Philippine authorities wish to explore the establishment of a contingency growth fund. Neither the Fund nor the World Bank is in a position to guarantee economic growth, much less guarantee a targeted level of growth. Given the limits to absorptive capacity already noted, plus the need to shift the locus of growth from the public sector toward private investment, the authorities would be well advised to concentrate on fundamentals.

To my mind, the best means of strengthening growth prospects is by implementing strong, comprehensive, and credible policies as spelled out under this program.

A word on the external sector. As economic recovery and trade liberalization stimulate imports, the performance of exports will become all the more critical to the external balance. The staff report has noted a number of problems faced by the export sector at present, and time will be needed to diversify successfully. The projected 8 percent growth in exports for 1987 may well be optimistic. This places considerable pressure on the need for exchange rate adjustment to support competitiveness and diversification, while tempering the demand for imports. While the authorities are prepared to intervene to avoid a real appreciation, we would hope that the steady removal of distortions from the economy will increasingly allow for a genuinely flexible exchange rate policy.

To conclude, in view of the Government's commitment to undertake a wide range of policies, and in view of the need to restore confidence and credibility for the Philippines, both at home and abroad, we support the request for a stand-by arrangement. As for the request for compensatory financing, we believe that all the appropriate criteria have been met, and can therefore support the amount of the proposed purchase.

Mr. de Groote made the following statement:

I especially welcome today's discussion for two reasons: first, because intensive discussions between Fund and Bank staff and the Philippine authorities have placed us in a position to approve today a comprehensive adjustment program which must permit the country to recover from a long period of depressed growth; and second, because the program before us involves the Fund in a new kind of adjustment strategy, which will pursue economic recovery instead of attempting simply to adjust balance of payments problems through retrenchment of domestic demand. The Fund's wholly justified role in this type of adjustment program will be to monitor the external imbalances that will arise as a corollary of the growth-oriented reform of the economy, and to help establish conditions under which, over time, a viable payments position can be made to coexist with sustained growth.

The salient features of the adjustment program will be the tolerance of a modest current account deficit throughout the adjustment period to create room for somewhat higher imports, and a temporary widening of the public sector deficit due to an expansion of investment expenditures. This public sector deficit will be progressively offset by increased tax proceeds and the elimination of government participation in unproductive activities. The programmed expansion of both imports and public sector investments seems necessary to support the transition of the Philippines from a highly institutionalized economy toward one in which the allocation of resources and other economic decisions are guided by market incentives.

The adjustment scheme is more flexible only in appearance than those which rely on reducing domestic demand pressures: because its success critically depends on the private sector responding appropriately to the reform process initiated by the Government, any deviation from the program objectives could be interpreted as a sign of purely expansionary government policies, an interpretation which would undermine business confidence in the new strategy, rekindle inflationary expectations, and damage the current account. Given this risk the adjustment path outlined by the present program will in fact be more constraining than most programs. In terms of this risk, the past adjustment record of the Philippine economy could turn out to be a double-edged sword, since past policies have in fact brought inflation under control and produced a small surplus in the current account, creating room for a transition to more accommodating policies. However, these successes have imposed their costs: they were only achieved through further institutionalization of the economy and an increasing absorption of scarce domestic resources by unproductive activities. The Government's new strategy will have therefore to displace some long-standing, deep-rooted methods of economic management, and I fully concur with the staff's view that this will be an ambitious and risky exercise. Success will require firm, vigorous policy actions in three major areas: maintenance of a flexible exchange rate system in order to ensure that the resources released to the private sector are channeled into increased export activity; close monitoring of the public sector imbalances to convince private investors of the soundness of the Government's program; and the pursuit of financial policies supportive of high savings and investment levels. It is to the Government's credit that it has made these objectives very much its own, and the only purpose of the comments hereafter is therefore to explore how to ensure their successful achievement.

The heavy reliance on a flexible exchange rate policy to support the Government's outward-looking strategy is a welcome development, especially so since it is combined with a further liberalization of the exchange and trade system that will allow the exchange rate to be determined by market forces on an economy-wide scale. Other important elements to support this strategy are the decision to monitor the exchange rate increasingly as a function of exchange rate developments in competitor countries in the Pacific region and the abolition of export duties. A combined reading of the staff paper on the request for compensatory financing and the background paper on the long-term trends in the export performance of the Philippines gives me the impression, however, that these policies may not suffice to produce the expected export recovery. At stake here is indeed not simply the replacement of traditional exports with nontraditional exports but the judicious diversification of a nontraditional export base which already represents the bulk of the country's foreign trade but suffers from a too exclusive reliance on a few products characterized by rather bleak market prospects and low value added in terms of balance of payments and general output effects. If the economy is therefore to diversify into nontraditional, labor-intensive, and natural resource-based items, as recommended by the staff, it would seem that, at least initially, the Government and possibly the World Bank should play an active role in this process by producing the appropriate incentives to channel investment funds to the appropriate export sectors. Any comment from Mr. Rye and the staff on the prospects for reorienting the country's investment program in this direction would be welcome.

Another proviso with respect to external policies relates to the desirable dimension of the current account deficit. I note from the supplement to the staff report that the Government's revised and slightly more ambitious growth targets over the medium term involve a corresponding widening of the current account deficit requiring additional external financing. Although the emergence of a current account deficit has to be accepted as a necessary corollary of the Government's growth-oriented strategy, I would encourage the authorities to monitor the external deficit and the underlying policies closely, both as a function of their contribution to medium-term balance of payments viability and of the country's prospective debt capacity. In this context, I would also like to add that a considerable improvement of the country's access to external financing, which in the light of the forthcoming domestic adjustment is not to be precluded, should not become a pretext to abandon the strengthening of the outward-looking character of the economy which is the ultimate goal of the strategy.

At the heart of the Philippine adjustment program is the correction of the large public finance imbalances that have over the years absorbed increasing shares of domestic resources at the expense of both public investment and private sector activity, and that have undermined business confidence in the economy both domestically and abroad. The present program makes a vigorous attack on these imbalances through wide-ranging reforms to be implemented in close collaboration with the World Bank, and I encourage the authorities to introduce them without delay, since important timing aspects are involved with respect to fitting them into the general strategy to which the Government has adhered. This strategy indeed aims at supporting a strong economic recovery through the restoration of adequate public investment activity and through the promotion of private sector activity, thereby paving the way for better competitiveness and export performance. If these two policy options are not to be mutually exclusive, and if the private sector is to respond positively to the government strategy, it is of crucial importance that the announced tax reform and the reform of the public enterprises be implemented convincingly, thereby mustering business confidence in the process, and that this reform succeed in releasing sufficient resources to permit the combined recovery of both private and public investment.

Finally, the success of the strategy will depend on the pursuit of a monetary policy supportive of high savings and investment levels. A major weakness in this area has arisen from the large spread between deposit and lending rates, which has prevented the favorable inflation record from being translated into accordingly lower interest rates, and illustrates the general disarray introduced in the financial system due to past mismanagement. I am confident however that the intended reform of the financial system and the attention paid by the Government to this fact will progressively allow the process of disintermediation to be arrested, paving the way for a more appropriate interest rate structure consistent with a smooth expansion of savings and investment.

In conclusion, the Philippine program presents a comprehensive and convincing set of measures to support the country's economic recovery in a way consistent with the further consolidation of the external adjustment, and I fully support the proposed decisions. Both the Fund and the authorities will have to be aware, however, that the success of the program depends critically on the strict implementation of a number of important institutional and structural reforms and on the private sector's response to the favorable investment climate created by these reforms. A question which I submit for consideration in this context is whether progress with these institutional and structural reforms could not have been reflected more compellingly in the performance criteria of the arrangement, which continue to be heavily oriented toward the reduction of the external debt burden and the monitoring of financial demand policies. I feel that a more explicit expression of the Fund's assessment over the desirable adjustment path with respect to these reforms would have been helpful to the authorities in implementing the required policies according to a mutually agreed timetable. Further consideration of this issue, at the occasion of our forthcoming discussion on program design and performance criteria, should also lead to a broad exploration of the possibility of translating the growth objectives of Fund programs into more explicit performance targets, also for countries which have to pursue their adjustment under severe external pressures.

Mr. Suraisry made the following statement:

I would like to begin by commending the Philippine authorities for the comprehensive structural measures they have adopted. These measures, ranging from tax reform to a dismantling of the sugar and coconut monopolies, are courageous, and in view of the difficulties facing the Philippine economy, are also necessary.

To elaborate, the task facing the authorities is that of restoring the economy to a path of sustained growth, while at the same time ensuring internal and external balance and maintaining a low rate of inflation. The strategy the authorities have adopted to this end involves pursuing, in the short run, an expansionary fiscal policy, with reliance on structural reform to generate longer-term growth. As the staff points out, this strategy is not without risk, particularly since it implies an increase in the fiscal deficit in the short run. However, much of the increase in the deficit is accounted for by an increase in investment and maintenance outlays. Given the sharp decline both in these expenditures and in the share of gross domestic investment in GNP over the recent past, a temporary increase of this type in the deficit can, in my view, be justified. It would be difficult to return to sustained growth without an increase in these expenditures.

In this connection, I detect, from the differing growth assumptions contained in the medium-term scenarios presented by the staff and the authorities, that there is some divergence of opinion as to how rapidly private sector activity can be expected to pick up. Staff comment on this point would be appreciated.

It is clear, however, that for the strategy to succeed, the private sector has to play an important role. The recent, decisive implementation of structural reforms constitutes a very important first step toward creating a positive environment for the private sector. Of course, as this chair has argued on other occasions, what counts over the longer run is the consistency and continuity of policy intervention. It is important that the authorities capitalize on the momentum their recent reforms have generated by sustaining their adjustment efforts. Mr. Rye's very helpful statement is reassuring in this regard.

There are a number of areas in which further policy actions would appear to be particularly important.

On fiscal policy, while a temporary increase in the deficit is, in my view, warranted, I would emphasize that the increase should only be temporary. It is important that the authorities implement, as scheduled, the prospective structural reforms, particularly as they relate to the nonfinancial public corporations and the government financial institutions. I understand that the authorities are working closely with the World Bank to reform the policy framework governing the financial public sector, and I wonder whether the staff can update developments on this front.

On the related matter of tax policy, the Fund, for its part, should continue to stand ready to assist the Philippines in its ongoing efforts at tax reform. These efforts have been very successful so far, and I am encouraged by the intention of the authorities to proceed further by replacing the turnover tax with a value-added tax. In this connection, I wonder whether the authorities are considering the possibility of a more complete globalization of the income tax and re-evaluating the gross tax on bank receipts? The latter tax appears to be contributing to a large spread between borrowing and lending rates.

On the external sector, as has been clearly documented in the supplement to the background paper, the Philippine export performance has tended to lag behind that of countries with which the Philippines is typically compared. While external developments have a role to play when encouraging exports, it is important to maintain a flexible approach to exchange rate management, and to reduce the traditional bias against exports. Encouraging diversification into nontraditional, labor-intensive, and natural resource-based items is also clearly important. I recognize that commendable progress has been made toward dismantling quantitative restrictions. However, further progress on tariff reform would seem to be desirable.

I note that the authorities have established an arrangement that allows for the conversion of external debt into equity investment. This is a step in the right direction. However, there appear to be a number of constraints, such as the use of a fee schedule, which may limit the scheme's applicability.

Further, I note from the supplement to the staff report that the authorities intend to initiate discussions with multilateral agencies aimed at the establishment of a contingency fund that would seek to ensure against the downside risks to growth. The clarification in Mr. Rye's statement is very much appreciated. But to decide on that matter, I believe more information is needed. More generally, the matter of a growth contingency raises fundamental policy issues, and it would be important for the Board to discuss these issues and the implications in the near future.

In conclusion, after a number of years of poor economic performance and fitful economic policy implementation, the Philippines is embarking on a comprehensive program of economic reform, with a view to restoring the country to a path of sustained growth. I am hopeful that the authorities will succeed. They have demonstrated their resolve by the policies they have already implemented. Accordingly, I can support the proposed decisions for the 1986 Article IV consultation and the stand-by arrangement. I also support the draft decision on a drawing under the compensatory financing facility. I believe that the Philippines satisfies the terms of the facility; in particular, the stand-by arrangement affords satisfactory evidence of cooperation with the Fund.

Mr. Goos made the following statement:

First of all, I would like to welcome the broad and indeed very high ranking representation of the Philippine Government in the recent discussions with the staff. I take it that this attests to the determination of the new authorities to cooperate constructively with the Fund in finding appropriate solutions to their economic problems, which in turn holds the promise of a successful implementation of the requested stand-by arrangement. Also reassuring in this regard is the general thrust of the new economic program that underlies the proposed arrangement and that appears to constitute an impressive adjustment effort, notably in the area of structural reform.

Since I am in full agreement with the staff's analysis and recommendations, I will refrain from commenting on all policy aspects. One aspect I should like to emphasize, however, and which is also addressed by the staff and previous speakers, is the obvious risk involved in the fiscal strategy. I certainly appreciate the authorities' concern that economic activity might need some fiscal stimulus in order to overcome the recession. But I am worried that the considerable degree of fine-tuning involved in the strongly expansionary fiscal stance this year, followed by a sharp withdrawal of the fiscal stimulus in 1987, could carry the seeds of increasing financial imbalances later on that would necessitate renewed recourse to severely restrictive policies to stabilize the situation.

As the staff rightly observes, the success of this strategy relies critically on the response of the private sector. That response will certainly take some time to materialize insofar as the structural reform measures are concerned: whether it will occur already this year or next year remains to be seen. What appears more doubtful, however, is the expected response to the fiscal stimulus, in particular since it is to be largely withdrawn again next year. Does this not imply an exceptional degree of "fiscal illusion" as a critical assumption underlying the adjustment program? And to what extent can such an assumption be considered realistic? I, for one, have considerable doubts in this regard, in particular in the light of the generally unpromising experience with fiscal fine-tuning. Furthermore, I fear that the increasing recourse to domestic financing implied by the higher fiscal deficit this year will put undue pressure on the still very high domestic interest rates. It is clear that this would run counter to the Government's goal of reviving private sector activity.

These considerations suggest that a more cautious and perhaps steadier approach to fiscal stimulation with less reliance on official domestic borrowing would probably be on the safer side than the stop-go pattern envisaged under the program. I therefore would recommend searching for ways and means to further contain the fiscal deficit. Incidentally, it might be interesting to recall that in the last stand-by review in December 1985 the staff had advocated a reduction of the public sector deficit below its 1985 level in order to ease the pressure on domestic interest rates. Unfortunately, it might be too late in the year to affect the fiscal outcome in 1986 in any substantial manner--and in this regard, it is regrettable that the program was not presented to the Board earlier. Here again I might recall that the last program was also presented so late in the year that there had been only a marginal possibility of influencing the policies of the preceding year. But in any event I feel that in the circumstances of the country the staff's advice to "monitor closely the key financial, external, and growth targets of the program, and be prepared to make [the] necessary revisions..." deserves our full support. Such a flexible stance in the implementation of the program seems warranted also with regard to monetary policy, the design of which could turn out to be somewhat overexpansive; and it would also recommend itself to the conduct of exchange rate policy. In this respect, I would encourage the authorities to assign a more active role to the exchange rate in the effort to strengthen the external sector. The intention of merely avoiding a real appreciation of the currency might fall short of the need to improve the competitive position vis-à-vis the country's trading partners, in particular in the Pacific region.

I noted from the supplement to the staff report that the authorities apparently share some of the concerns I have just expressed about the responsiveness of the private sector and that they are therefore considering the establishment of a foreign-financed growth contingency fund. While such a fund could theoretically even out the stop-go pattern of the envisaged fiscal policy stance, at least two reasons argue for caution. First, there is the question already raised by previous speakers of how the additional financing could be usefully employed, given the World Bank's assessment that the funds earmarked under the existing investment and maintenance program might already be encountering absorptive constraints. Second, there would be an additional accumulation of foreign debt, a rise in the debt service burden, and an increase in the external financing gap and, hence, consequences that would tend to weaken external creditworthiness, above all, investors' confidence. Similar concerns do also arise with regard to the authorities' new medium-term scenario, which in addition seems to be difficult to reconcile with their objective of strengthening the role of the private sector. However, I would agree with the previous speakers that it is probably premature to draw firm conclusions on those plans, except perhaps that the Fund's short- to medium-term resources would certainly be inappropriate for the financing of a growth contingency fund. Apart from that, I would agree that the plans should be assessed in greater detail when more information becomes available, and, in any event, in the context of the forthcoming program reviews.

In the meantime, and in view of the authorities' reaffirmation of their commitment to the proposed program, which has been echoed again in Mr. Rye's helpful statement, I would like to conclude by reiterating our support for both the staff appraisal and the proposed decision on the requested stand-by arrangement.

Turning now to the requested compensatory drawing, I would agree with the staff that the relevant requirements for a drawing are largely met. Nonetheless, I have some reservations with respect to the temporary nature of the shortfall. Considering the figures on the various export items presented in the staff paper, it appears that virtually all of the traditional exports are on a steadily declining trend. Accordingly, in the postshortfall years those exports are projected to reach less than 40 percent of the earnings recorded in 1981, and also their share in overall exports shows a pronounced decline from 52 percent to 23 percent in the same period. These features strongly suggest that the calculated shortfall represents to a considerable extent longer-term structural weaknesses in export performance and hence weaknesses that require other instruments of support than the compensatory financing facility.

I therefore would have preferred to see a higher share of the proposed Fund financing provided through regular drawings. Yet because the proposed compensatory drawing would remain substantially below the calculated shortfall, and also in recognition of the commendable structural adjustment effort of the authorities, I am prepared to give the country the benefit of the doubt. I therefore could go along with the proposed decision provided it finds the support of the majority of the Board.

Mr. Polak made the following statement:

The staff report for the 1986 Article IV consultation and the request for a stand-by arrangement for the Philippines contain a number of definitely favorable elements. Inflation has been brought down to the 5 percent range, although the staff's reference to the elimination of inflation in its appraisal seems a bit optimistic; the current account is in balance; arrears have been eliminated according to the schedule; reserves are at a reasonable level; and on plausible assumptions the debt ratio will be declining. These are indeed unusually favorable starting conditions for a stand-by arrangement.

More positive news is to be found in the remarkable array of policy measures that the Government has put in place or to which it is committed. Section VI of the staff report on structural reforms testifies to the width of the range of measures on which the Government has moved forward. The six policy issues that are being addressed are those that have bedeviled policy in the

Philippines for a long time; it is therefore a matter of great satisfaction that the new Government has found the courage to tackle all of them in a decisive way in its first few months in office. I would support, without entering into detail, the general thrust of the progams undertaken. The Fund and Bank staffs are also to be congratulated on the catalytic role they have played in encouraging action on so wide a front. The annexes show how in some circumstances detailed work by the Fund staff on the micro-level can be of great value in understanding the macropolicies of the authorities. I was particularly interested in Annex IV with its detailed discussion of public investment expenditure and Annex VI on the reforms in the sugar and coconut sectors.

These and other passages in the report suggest the existence of close collaboration not only between the Fund and the Bank, but also of the two institutions with authorities who know very well what their policy objectives are and have a well thought-out strategy to attain them.

The specifics of the macropolicies also seem plausible. With respect to the exchange rate, the traditional homage to "a genuinely flexible policy" is paid, and that policy last year was allowed to produce an unwanted real appreciation of the peso. But this is well tempered by the clearly spelled-out objective of "ensuring [a rate] that is sufficiently supportive of an export recovery and trade liberalization," and this is, for good measure, supported by targets for reserve accumulation.

Fiscal policy is presented as providing a strong stimulus in the second half of 1986, followed by retrenchment to a deficit on domestic transactions of 2.4 percent of GNP in 1987, which is supposed to leave adequate room for private investment. Perhaps a more informative way to present the facts is that capital outlays and maintenance expenditure needed to be greatly increased in 1986--a year that in any event is nearly gone--over the low levels of recent years that will continue in 1987; but by that time the new tax measures will have taken hold to reduce the deficit to manageable proportions. In other words, there may be less fine-tuning than meets the eye--and he would be as worried as Mr. Goos if there were that kind of fine-tuning. Monetary policy is directed at maintaining a low inflation rate, assuming there is the expected response in real growth, in conjunction with the fiscal policy envisaged. These money growth rates will produce the needed room for credit to the private sector. However, a warning is necessary: the amounts of money growth could prove excessive if the growth response falls short of expectations or if the assumption with respect to a fall in velocity, which I find plausible enough in itself, fails to materialize. The reviews to set limits beyond March 1987 for the monetary variables are particularly important in this connection.

More generally, no one can deny--and, in fact, everybody has stressed so far--that the policy package that the Philippine authorities have embraced contains considerable risks. The risks are essentially twofold: the uncertainty about export developments and the uncertainty whether investor confidence will return strongly and quickly enough. These two risks are to an important extent interrelated, and both depend, as the staff states, on the credibility of the Government in the pursuit of the structural reform program. On this, therefore, all efforts will have to be concentrated. Not only the eyes of the Philippine commercial business community but also those of the international community will be focused on the timely performance of the authorities. Even without performance criteria (and here I refer to Mr. de Groote's points on this matter), performance on this aspect of the policy package will be crucial to the Fund reviews. As the staff states, however, in the last paragraph of its appraisal, even the best of policies do not guarantee the timing and desired strength of recovery in the private sector.

This brings me finally to the suggestion contained in the supplement to the staff report, and helpfully elucidated in Mr. Rye's statement, that the authorities would like to discuss the establishment of a contingency fund "to ensure against the downside risks to growth." Such a fund has obvious attractions at first sight, but these should not obscure its very real risks. If growth fails to pick up, it may be because of disappointments of external origin. But it may also be because of underperformance of the authorities in their implementation (or in the perception of their future implementation) of the structural components of the program. If the cause is the former, there is a case for a contingency plan of stimulative action. If the latter, such a plan can only further undermine confidence. And too much emphasis on such a plan may create the fear that the authorities are less than fully behind the structural program and may thus cause the very contingency to arise. My conclusion on this aspect of the plan would be for the authorities not to follow the Mexican example, and not to seek agreement on an automatically triggered contingency clause, but rather to explore the relevant aspects, putting any such plan into operation only if a review showed that the shortfall in growth was convincingly attributable to exogenous causes.

With these comments, I support the decision on the stand-by arrangement. I also concur in the proposed compensatory drawing, which in my judgment meets the tests specified in the decision on compensatory financing.

The Chairman said that he could agree with what Mr. Polak had said on the growth contingency in the case of the Philippines.

Mr. Foot made the following statement:

I would like to join other speakers in welcoming the chance today to comment on a bold program of economic reform and to endorse the Fund's financial support for this program.

Unlike other speakers, I should like to comment first on the compensatory financing transaction, for two reasons: first, because it is larger than the amount of the stand-by arrangement, both over the whole 18 months of the arrangement and in terms of the resources that it releases in 1986, when it actually makes available nearly ten times more money than the stand-by arrangement does in that period; and second, because by definition the request for compensatory financing focuses on export performance, the future of which, as other speakers have already noted, will be the key to realizing the Philippine authorities' hopes for the future.

I accept without reservation that the Philippines has a balance of payments need and that it has fully met the requirement of cooperation with the Fund appropriate for the size of the requested compensatory financing drawing. The stand-by arrangement before us today is ample proof of this cooperation. I can also go along with the view that the size of the export shortfall justifies the request, but here I have three reservations of principle about the calculations and the way they are presented.

First and most important, the shortfall on a number of manufactured exports must have been related to the substantial--over 10 percent--appreciation of the exchange rate during the second preshortfall year. This is stated without reservation in Annex I of EBS/86/223, and I was disappointed that, on page 10 of the main part of this paper, the exchange rate appreciation is referred to as only a possible factor underlying the shortfall on a limited range of manufactured exports. It would have been interesting to have a quantified projection of what exports might have been had the exchange rate appreciation not occurred; and I would suggest that such quantification be attempted in future cases. I accept that the results would be open to dispute. But this is true of many of the calculations underlying requests for compensatory financing; and if the estimate of the effects of exchange rate changes are good enough to be incorporated in a quantified stand-by arrangement--as they inevitably are as part of the process of forecasting the outlook--they are surely good enough for the calculation of the compensatory financing itself.

Second, I note that SDR 20 million of the shortfall arises in respect of petroleum products, in respect of which the Philippines is a heavy net importer and therefore has been a major beneficiary (by, I think, $600 million a year) of lower petroleum prices. A further part of the shortfall follows from a decline in the price of exported electronic components, many of which are imported to the Philippines, processed, and then exported. I have to register continuing difficulties, which I have mentioned before, with the principle agreed in this Board in 1982 that the calculation of export shortfalls should never take account of related changes in import prices. The Philippines seems to me to be a classic case of the logical result of the Board's decision: a major processor of any raw material--oil, gold or diamonds are three commodities which come to mind; or semifinished products, such as electronic components--can obtain benefits under the compensatory financing facility to which in any objective sense it should not be entitled, because the decline in the export price of the product is counted in the calculation while the benefit of the decline in the import bill is not. In the case of the Philippines, the shortfall on these accounts is not significant relative to the size of the requested drawing, and even if taken out in full, does not affect the validity of that request. But it is a point which may matter more in some future cases and to which I shall undoubtedly want to return in the forthcoming review of the compensatory financing facility.

Third, I was surprised to see no discussion of the reliability of the export statistics, or, indeed, in the main staff report of the import and export numbers. I would refer here to two pieces of work that might be described as circumstantial evidence, although neither says anything a priori about whether the shortfall is overcalculated or undercalculated. The first is an academic study conducted in the Philippines by the Centre for Research and Communication, which estimated that for a fairly clearly defined and homogenous item--garments imports--the value of imports over the years to 1983 was generally overstated by 4 percent. Such incorrect invoicing is a common feature for countries where capital flight is prevalent, and there have clearly been times in the past in the Philippines when such flight has taken place.

A second work in 1986, which shows a rather different picture because it identifies underrecording of imports subject to customs duty, stems from the recent operations of a Swiss firm which preinspected a range of cargoes bound for the Philippines. Nearly 80 percent of these cargoes were found to be underinvoiced or incorrectly invoiced, and additional revenue equal to about 9 percent of the value of the imports concerned was obtained. I very much welcome the decision by the Philippine authorities to employ this company on a regular basis and thereby tighten up on this not insignificant source of revenue. But if there has been underinvoicing of imports subject to customs duty, there presumably has also been underinvoicing of exports, especially when export taxes existed, as they did for part of the period covered by the calculation of the export shortfall. I would therefore welcome any comments from the staff--either in respect of the requested drawing or more generally on the quality of past statistics in this whole area.

All these points made, as I indicated at the beginning of my statement, I am able to support the authorities' request. In the aggregate, the case is not undermined, and in particular it is helpful that the identified shortfall exceeds the amount requested by a significant margin, which helps to allay questions of the type I have raised.

So far as the stand-by arrangement is concerned, let me start by noting that here is a case--and there are all too few--where the program of reform is: bold and comprehensive; already under way; and springs in large part clearly from the authorities' own priorities and planning. All these factors make the program easier to support and increase our confidence that the authorities will have the drive to see it through. All these are encouraging points. But given the large existing external debt of the Philippines and the extent of the structural imbalances to be corrected, it seems necessary to consider in a little detail four key and interrelated areas which will determine the eventual success of the program. All of these aspects have been covered by previous speakers, so I can be brief.

The first is the rate of growth. In the short run, if I have understood correctly, the authorities are looking for a jump start to the growth process from a carefully targeted fiscal stimulus, together with--and hopefully aiding--a revival in private sector confidence. Looking further ahead, as Mr. Goos has already noted, the effects of the fiscal stimulus will fade in importance--the 1987 consolidated public sector deficit is projected to return to its 1985 level--and the key domestic determinant of an adequate rate of growth will then become the success of the structural reforms to which the authorities are committed.

Though it is not without risks, I found the strategy and objectives outlined in EBS/86/222 highly plausible and therefore the more likely to succeed. I was much less confident about the higher growth scenario mapped out in Supplement 1 to that paper. While faster growth is, of course, a valid objective if circumstances permit, the Philippines is already a highly indebted country. Consequently, a strategy implying--as the higher growth scenario seems to--rapidly increasing financing gaps may not only inevitably be unsuccessful but, indeed, may worsen the outlook by undermining confidence, a point that I believe was alluded to by Mr. Goos. I would, therefore, urge the Philippine authorities to be very wary of pushing their growth targets beyond those incorporated in the stand-by arrangement. Additional public spending now will crowd out the private sector, even where there is underemployment of resources, if it is done in a way which reduces confidence and puts upward pressure on domestic interest rates or downward pressure on the exchange rate.

With respect to the question of a contingency fund for growth, I would endorse Mr. Hodgson's remarks, although the substance of the general issue needs to be left to the upcoming paper on innovations in Fund-supported programs.

The need for care on the growth targets is all the more important because the staff papers--notably that on the request for compensatory financing--make clear the fact that raising Philippine exports, and therefore keeping the current account manageable, will be no easy task. Much will depend upon the state of the U.S. market, which I see takes over one third of all Philippine exports. Much too will depend upon the way that the new policy toward the encouragement rather than discouragement of exports is actually carried out.

A third key area that will determine the success of the whole program is the speed with which the comprehensive program of reform is pushed through. With respect to tax reform, the proposed scope of these measures--generating enhanced incentives for investment and export, and much needed additional revenue--seems particularly and admirably suited to the needs of the economy.

The same I think can be said for the other key areas of intended structural reform, notably in respect of trade liberalization, parastatal reform, and the elimination of monopoly powers. Import liberalization, as several speakers have noted, holds particular potential benefits; and while consultations with affected industries have delayed somewhat the original timetable, the pace of deregulation is encouraging. Also welcome is the statement by Minister Villafuerte early in October, which Mr. Hodgson already mentioned, on the needed reform of parastatals, and the proposals to sell, consolidate, or abolish over 160 state enterprises (see page 32, EBS/86/222).

To conclude with a few unconnected remarks, first, I would strongly support the emphasis laid by other speakers on the need for a continuing flexible and appropriate exchange rate policy that almost goes without saying. Second, on monetary policy, I would like to endorse the remaks made by Mr. Fujino. It seems to me that there is a strong argument for a careful review of the 1987 position. Third, I would be interested in staff comments on the question whether the debt equity scheme described on page 15 of EBS/86/222 is actually likely to be attractive enough. I think Mr. Suraisry has already discussed this point. It seems to me that such a scheme depends upon existing debt being available for sale at a sizable discount abroad. Once the Government's policy shows the success that we are all hoping for, there is unlikely to be such a discount on this debt, and therefore the fact that quite a sizable fee of 5 or 10 percent is attached to transfers in certain preferred sectors appears to be a rather odd feature of a program designed to encourage this particular activity.

In sum, this is a brave program which seeks to tie much needed structural reform into a growth-oriented schedule, supported by the authorities, the Fund and the Bank, which as Mr. de Groote in particular has remarked have cooperated in an exemplary fashion throughout this exercise. Inevitably there are question marks. But these can be minimized by domestic policies to foster the revival in confidence in the domestic private sector and to ensure the foreign creditor support which will be needed. The proposals in EBS/86/222, and fully endorsed by the Philippine Government, deserve our wholehearted support.

Mr. Hospedales made the following statement:

The staff, in a well written and balanced technical report, has appraised recent economic developments as well as the objectives of future public economic policy in the Philippines. We are in general agreement with the thrust of that appraisal. We support the decision relating to exchange measures. We wish, also, strongly to support the requests for an 18-month stand-by arrangement and for a compensatory financing purchase; in our view, the Philippines has met all requirements for use of this facility.

For a number of years the Philippines, in close cooperation with the Fund, and with mixed results, has been grappling with an economic and financial crisis stemming from a rapidly changing and deteriorating external environment and internal problems. It is to the credit of the new Government that it was able to come to terms quickly with the complexity of the task facing it and adopt a comprehensive and timely adjustment program that merits Fund support.

In light of the depth and duration of the domestic recession--real GDP had declined cumulatively by 10.6 percentage points over the last two years--the Philippine program is growth oriented and aims at preserving the recent gains in price stability and strengthening further the external current account position. The relief offered by declining oil prices and the existence of idle resources, together with positive macroeconomic conditions already in place, should, in our view, ensure the achievement of the objectives set by the authorities. Their firm commitment to the program is emphasized by Mr. Rye in his most helpful statement, which gives us confidence in the program's ultimate success.

A key element in the adjustment program is the achievement of an enduring reduction in the public sector deficit over the program period. However, given the immediate priority of initiating the recovery, fiscal strategy has been designed very correctly to strike a balance between the need to stimulate a recessionary economy and the need for the long-term pursuit of financial discipline, in the process creating room for private sector expansion to sustain the recovery. With the economy already in recession, any attempt to do otherwise could have undermined the present fragile socioeconomic stability prevailing in the Philippines. In this connection, the authorities are appropriately alert to the need to take necessary measures if private sector initiatives do not materialize; for this reason, we urge the multilateral institutions to give due consideration to the Philippine request to establish a contingency fund, which in our view would trigger the implementation of additional selected investment projects if the economy shows signs that the growth objective as envisaged--6 1/2 percent over the next year--is not materializing, especially if it is interrupted through exogenous developments.

The planned strategy of medium-term fiscal consolidation therefore allows an initial domestic fiscal stimulus of approximately 2 percent of GNP, based on a capital expenditure program which is conceived as selective and, in particular, employment generating. Additional investment should flow from the welcome reform of the coconut and sugar subsectors. We view the continuing close cooperation with the World Bank in these areas as particularly important. The increasing share of investment in GDP is an important determinant for creating a pro-growth environment. Consistent with the particular approach being pursued, the fiscal effort is aimed at laying the base for sustained improvement in the public sector resource mobilization effort. Therefore, the consolidated budget deficit is being limited to approximately 2.4 percent of GNP by 1987, the financing of which is manageable and equally shared between domestic and foreign sources. A combination of wide-ranging measures, including a comprehensive tax reform exercise, is expected to strengthen the elasticity of the tax system. The authorities are, however, aware of the significant downside risk involved in this exercise. For this reason, we welcome their commitment to take appropriate revenue raising or expenditure restraining measures in the event of revenue shortfalls so as to keep the consolidated public sector deficit within the limits imposed by the program. We welcome also the long overdue financial and managerial reorganization of the major nonfinancial public corporations: their profitability and reduced dependence on budgetary resource transfers are vital to the progress of the Philippine program.

We feel that the plans in the monetary and credit areas are consistent with the need to accommodate the recovery, the slowing down of inflation and the achievement of the international reserve target. The flexibility in the program for the targeted growth in key monetary aggregates recognizes correctly that monetary management will continue to be complicated by strains in the financial system, and there will thus be a measure of uncertainty with respect to the general public's demand for financial assets. In this light, and bearing in mind the reorganization of the financial sector, the behavior of prices and monetary aggregates will need to be closely monitored to determine the measures needed to keep the program on track in respect of fiscal and credit policies. In this connection, the lower but positive real interest rates now prevailing will be a key contributing factor in the efficient mobilization and allocation of financial resources.

The need to enhance capacity output in the longer run and to channel resources into the export sector is being facilitated by an appropriate flexibility in the management of exchange rate policy. The implementation of a comprehensive and equity-oriented incomes policy and the liberalization of commercial policy are sound complementary arrangements. The Philippine authorities are well aware that the extent and speed of this process and, therefore, its benefits--new investment, external competitiveness and strengthened international reserves--will be crucially determined by the volume of external resources in the period through 1988 to enable the country to improve its capacity to grow and meet its external commitments; we support, therefore, the new approach to the Paris Club and commercial banks for rescheduling arrangements in addition to the existing arrangements for exceptional financing. Over the longer term, bilateral and multilateral support will be needed subsequent to the completion of the economic program.

There is one final point. We note that access under the proposed stand-by arrangement is extraordinarily low when compared to that of Mexico. We believe that there is a clear case for larger access in the light of the magnitude of the problems being experienced by the Philippines, the response of the authorities to these problems, and the need to signal to creditors that the Fund will continue to play an important role in that country's adjustment efforts, not to mention the importance of uniform treatment for all our members.

Mr. de Forges made the following statement:

The staff reports give us a thorough description of the situation in the Philippines and an in-depth analysis of the problems the authorities are now committed to tackling and, hopefully, resolving. Since I am in general agreement with the staff assessment, and since I generally support the program being implemented by the authorities, I will limit my comments to a few points.

The most impressive component of the package before us is, more than the financial program itself, the variety and the span of the structural reforms decided upon by the Philippine authorities. Some of them have been awaited for some time now, particularly as far as the government financial institutions and the agricultural sector are concerned. All are necessary; they will profoundly modify the economic environment; and they are building the foundation of the expected recovery, which is why they have to be pursued strictly and according to schedule. Let me, on this point, welcome the involvement of the World Bank in some aspects of the reforms; its enhanced collaboration with the authorities and with the Fund is really welcome.

An essential feature of the program is that it is very clearly growth oriented and I welcome this orientation. Such an approach was necessary because the recession suffered during past years must clearly be reversed. Such an approach is possible in this case, since the financial aspects of the program seem to be balanced.

The Philippine authorities were in the classical but sensitive situation of having to find the path toward more sustained growth in the framework of already increased external indebtedness. Thanks to the external adjustment achieved and to the almost complete elimination of inflation, the stimulus given by fiscal policy in 1986 is affordable, provided that the expected reduction in public sector imbalances is effectively obtained in 1987 and in following years. The latter outcome will depend directly on the effectiveness of the tax reform.

As clearly emphasized by Mr. Rye in his very precise and informative statement, the strategy chosen by the authorities relies critically on the private sector response. The reference to past situations gives us, rather than reference levels for output or investment, the certainty that there is room for an impressive recovery, which will nevertheless have to be orderly and medium-term oriented in order to be sustainable and financeable. The implementation of structural reforms will result in a far better situation than prevailed in the early 1980s, and will ensure that recent economic history does not repeat itself.

The outcome of the program in the medium term will depend largely on a steady flow of significant external financing, possible only in a stable and confident environment. In this respect, overoptimistic assumptions could be counterproductive. Confidence in the Government's strategy is indeed an essential component of the expected growth. This confidence has to be expressed in the timely implementation of the structural reforms as well as in the close monitoring of the macroeconomic balances. Since the program appears to be a tight one, with a very close interdependence of the various hypotheses and results, preparedness for frequent revisions in light of new developments is absolutely essential.

As regards the program period, instead of establishing a contingency growth fund, we would prefer openminded reviews in the event that the growth objectives are not met; previous speakers have already expressed sound reasons for this strategy. We will have the opportunity, however, to tackle this issue on a more theoretical basis in the near future.

In conclusion, I am pleased to commend the Philippine authorities on their clear commitment to the implementation of the various elements of the program, which appears to us to be well designed, albeit ambitious. It is this ambition which makes a precise monitoring of developments, and an ability to respond rapidly to these developments, especially vital. Therefore, I support the proposed decisions on the stand-by arrangement and the compensatory financing transaction.

Mr. Puro made the following statement:

In recent years the economic performance of the Philippines has been rather poor. Lack of consistent policies, economic mismanagement, and, to some extent, unfavorable external developments have characterized the economy. Despite successive Fund-supported programs that have caused the Philippines to be a long-term user of Fund resources, the economy gradually slid into an economic and financial crisis. It is now necessary to intensify crisis management considerably in order that a sound economy may be restored.

The Philippine authorities have indeed prepared an impressive economic program. Recent information by the staff indicates the authorities' intention to produce an even stronger growth alternative to the initial program. This chair finds that original program is already comprehensive and ambitious. We hope that the authorities can mobilize the administrative capacity and public support necessary for its implementation.

The strategy behind the program is based on an analysis that lasting economic progress can only be reached by dismantling administrative and other restrictions and by reorienting the economy toward the private, rural, and export sectors. One may wonder, however, whether the measures planned are sufficient and whether their full implementation is possible. The initial step in the program is to inject a strong fiscal stimulus into the economy in the second half of 1986. This takes the form of a large increase in government investment and maintenance expenditures. The withdrawal of stimulus in 1987 would provide financial room for an increase in private sector activity, especially for investments in the export sector. An essential part of the strategy is to create the necessary confidence in the private sector. The staff points out that many conditions essential for the recovery are in place. Among them are reduced inflation, the decline in oil costs, and substantial labor reserves. In addition, some of the proposed structural and management reforms are gradually being implemented.

The critical question is whether fiscal stimulus and an improved environment are sufficient to create the strong private sector response required. For the fiscal stimulus to be effective the policy has to be fully implemented. No lags due to delays in project planning and implementation are permissible. There is no doubt that the private sector needs to believe strongly in its future to have the incentive to expand its activities, especially in a situation where export demand remains weak. The Philippine authorities are undoubtedly on a knife's edge. If true private sector recovery does not materialize the chances for future growth are indeed endangered, as there are neither opportunities nor room to continue to expand the public sector without essentially changing the nature of the economy.

Let me now address a few policy areas. The fiscal strategy in the Philippines is based on the fact that the present public sector deficit puts a strain on domestic financing and limits the resources available for the private sector. This chair endorses the strategy and welcomes the authorities' intention to reduce the deficit; in that connection, the target for its reduction in 1987 is significant, but has to be seen against the background of the 1986 expansion. Even beyond 1987, we would encourage the authorities to follow a carefully planned policy on deficits in order to secure sufficient room for private sector financing. Among the different structural reforms in the public sector, the tax reform seems greatly needed. It will make the tax system more effective and provide enhanced incentives for investment and growth. In the implementation of the reform the authorities have indicated that they will take a firm stand with respect to the size of the budget deficit, and it is hoped that this will be carried out without slippages. In the public sector, the institutional and tariff reforms for the nonfinancial public corporations and the reform of the government financial institutions are very important; through their improved productivity and profitability, reliance on public resources can be reduced. As these reforms have to be carried out over several years, close monitoring of their progress is needed. Reductions in the public sector deficit would considerably facilitate the financial markets' accommodation of private sector needs. It would also reduce interest rates. To increase the efficiency of the monetary system and to facilitate the stimulation of economic growth, distortions in the interest rate structure should be eased.

On the external side, the intended pursuit of a flexible exchange rate policy would seem appropriate. A competitive exchange rate can be a major incentive to developing a more diversified export base. The trade liberalization measures taken in recent months have been commendable, and a gradual approach seems to be warranted. However, the authorities should avoid delaying the liberalization process. Further liberalization measures are needed to make the necessary inputs available and to strengthen competitiveness in domestic markets.

The medium-term projections point to a slight easing in the external constraints on economic development. The current account deficits continue but they are consistent with an improvement in the external debt situation. The financing gap seems to be manageable. Rescheduling agreements are likely to reduce the need to rely upon concerted exceptional financing packages. A multiyear rescheduling arrangement would be welcome to further stabilize debt payments if it can be agreed upon with the creditors.

In his very interesting statement, Mr. Rye has elaborated briefly on the authorities' intention to negotiate a contingency fund against downside growth risks. It is too early to give even preliminary views on the matter. We would, however, recall that in the Mexican case the understanding was that contingency clauses should not become a standard program feature.

The staff has produced a very illuminating sensitivity analysis on external developments. If some of the so-called worst-case elements were to occur simultaneously, the Philippine situation would easily become very difficult. The best way to bolster the economy against unexpected developments is to promptly implement the planned economic policies. Slippages would jeopardize the restoration of confidence and medium-term economic growth.

Finally, a few words about the proposed drawing under the compensatory financing facility. The Philippine balance of payments developments seem broadly to justify a purchase under the facility. The shortfall in export volume across most export categories occurred despite a substantial depreciation in the exchange rate, and it was largely beyond the control of the country. As for the temporary character of the shortfall, the doubts expressed by Mr. Goos may be warranted. Cooperation with the Fund has been of a long-term nature; although the successive stand-by arrangements of the Philippines have had only limited success, cooperation has been good, which augurs well for the new arrangement. All in all, we can support the request under the facility, and we can also support the proposed decision on the stand-by arrangement.

Mr. Jaafar made the following statement:

There is much in this proposed stand-by arrangement that I can strongly endorse, most prominently the growth strategy, which is basically taken up in the early part of that package, where recognition is given to the need to turn the economy around with an initial dose of strong fiscal stimulus in the second half of 1986. Whether or not such a stance will be adequately maintained in 1987 and beyond is of course debatable. I can fully endorse the points made by Mr. Goos and Mr. Polak in this respect. However, what is important is that this program is one of the few that has benefited from the recent reorientation of Fund-supported economic adjustment programs. I hope to see more of this kind of program in future stand-by arrangements.

In terms of the program before us, like the staff and others, I do recognize that much remains uncertain. Of crucial importance is the assumption made regarding the role that private sector initiative is expected to play in 1987. Two factors will be crucial in the context of the Philippines. First, I believe that the response of the private sector will depend, to a considerable extent, on a strong recovery of the external sector, especially on the export side, not only to strengthen the external position but also to stimulate the economy for an export-led expansion.

It is with regard to growth that I am quite sympathetic to the notion of establishing a contingency fund, to which reference is made in Supplement 1 of EBS/86/222. A similar arrangement was made for Mexico recently. Mr. Rye has also mentioned in his statement the attitude of his authorities to such a contingency plan. This chair, like Mr. Fujino, agrees that not much can be said about this plan until it is looked at in more detail at a later time. Meanwhile, I would apreciate a little more elaboration from the staff. Like Mr. Polak, I am much in favor of the Philippine authorities resorting to this arrangement should a review firmly establish that growth has been adversely affected by exogenous factors.

Second, there is much need for progress in the Philippines on both the structural and institutional reforms which have been elaborated in detail in the staff paper. Real progress is indeed essential under this program despite the fact that the results will be seen only in a medium-term context. Progress is essential in order to restore confidence of the business community, both domestically and abroad, thereby paving the way for greater private sector participation in the economy.

Finally, I would also like to support the request for use of the compensatory financing facility. I am fully satisfied that the need and the rationale of the request are as described in the staff paper.

Mr. Huang made the following statement:

The outlook of the Philippine economy has been fundamentally changed since the economic reform program was drawn up by the new Government. A quite marked recovery may well be starting, and the contraction of the economy has been reversed. Meanwhile, inflation has continued to decline and the external position has eased. It appears that the economy is set to move in the right direction, although there is still a long way to go before it is fully restored to its pre-1983 crisis situation. Obviously, the new Government has been facing very severe economic problems since it assumed power not quite ten months ago. Given the difficulties experienced, the authorities are to be commended for their courage, determination, and effectiveness in reforming such a mismanaged economy.

As I am in broad agreement with the staff appraisal, I will highlight just a few observations:

It is evident that the losses of the government-owned corporations represent a heavy burden on the state budget and a major drain on resources. Therefore, a sweeping reform of those corporations is a task which brooks no delay.

It must be pointed out that export prospects for the Philippines are not encouraging, with the price outlook for most traditional export commodities being rather poor. Taking into account the large build-up of external debt and the rising debt service payments, it is apparent that strengthening the export sector is a matter of vital importance. To this end, diversifying and broadening the export base would be a fundamental solution, together with a flexible exchange rate policy, trade liberalization, and tariff reform.

Thus far, the improvement has not yet shown up in higher investment, which is an essential element for a full recovery of the economy. In this connection, I would assume that confidence is a critical factor in affecting investment decisions. I am particularly in agreement with the staff's view that the key issue at the moment is the credibility of the Government's commitment to reduce public sector imbalances and to undertake structural reforms. I hope the momentum will be preserved and the problems decisively addressed. With this in mind, I believe the Philippine economy stands a good chance to move onto a path of sustained growth.

In view of the above, I can support the stand-by arrangement and the proposed decision on the use of the compensatory financing facility.

Mr. Dallara made the following statement:

The Philippines has been a prolonged user of Fund resources, having had eight upper credit tranche arrangements in effect almost continuously over the past decade or slightly longer. Economic performance under these programs throughout has been rather mixed. Some important progress has been achieved, but at times progress has been reversed. And, generally, some rather fundamental underlying structural problems have not been resolved--problems which have impeded the achievement of sustainable economic growth in the context of a viable external position.

The Philippines now has a new opportunity, a new environment for economic adjustment and reform. We are encouraged that the authorities are seizing this opportunity by developing and already putting in place a number of elements of a comprehensive economic program. We commend the authorities for the boldness of their vision, the breadth of their approach, and the depth of their commitment to tackle the difficult problems which face the Philippine economy through an overall effort to restore confidence, to achieve sustainable growth, and to do so in the context of a sustainable payments position. We believe this program merits the support of the international financial community and justifies continued Fund support over the next 18 months with broad ranging policy advice and modest financial assistance, in close cooperation with the World Bank and other creditors and donors. In sum, we are prepared to support this program and the proposed decisions before us today.

Before turning to specific elements of the program, we would first note that the improved financial environment that has been created by recent adjustment efforts, some favorable external developments, and the economic strategy which has been embraced by the new Government all place the authorities in an excellent position to move ahead in their effort. We recognize, of course, that some of this progress--for example in the external accounts--has been achieved in the context of negative growth and, therefore, must be viewed with a degree of caution. However, we do believe that present circumstances offer an opportunity to the Government of improved prospects for long-term economic growth. The program is comprehensive, with new emphasis on agricultural development, export growth and diversification, and greater reliance on the private sector as the main source of growth. In that connection, we noted with interest the comments by Mr. de Groote and others that the program contains a number of important elements of structural reform. It is an operational example of some of the issues and concepts of program design which we were discussing in a more theoretical framework just a few days ago. Perhaps it poses a challenge to us to make an effort to integrate structural reforms into our program design. Although we recognize the extent to which the structural components of this program are incorporated into the program design through review clauses, some further attention to *the integration of structural elements in Fund programs generally* would be appropriate.

Turning to some of the specific elements of this program, it is clear that further improvement in the domestic financial environment and prudence in the conduct of monetary and fiscal policies will be required during the period ahead, while heavy emphasis is to be given to an array of structural reforms. These, of course, include tax reform, the reorientation of public expenditure, trade liberalization, reforms of financial institutions, and agricultural reforms in a number of sectors, notably sugar, coconuts, and foodgrains. We particularly welcome the fact that the authorities have already dismantled monopolies which existed in several areas and that free trade is being restored in those sectors.

Regarding fiscal policy and public expenditures, the authorities appear to be adopting, temporarily, a deliberate policy of fiscal stimulus through investment expenditures as an initial element in this Fund-supported program. We are prepared to support this approach, but a few points need to be recognized. First, to some extent fiscal stimulus will be the inevitable result of actions taken before the current Government took office and of the inevitable difficulties that any new government faces in coming to grips with its fiscal policies and plans. In fact, it is not entirely clear to me that the fiscal stimulus approach would have been the approach adopted by the authorities for this year had they had an earlier opportunity to assess the fiscal situation. Second, we would agree with the implication in the staff report that, in spite of the earlier excess spending, there is some leeway in the current financial situation to permit additional investment expenditures and that this leeway has been enhanced by the somewhat exceptional external financing environment. This is because concessional financial support has been provided by my authorities and by other donor countries and development institutions in recent months. Therefore, we recognize and support the authorities' intention to take advantage of this leeway during the course of implementing their investment plans for this year. In particular, we welcome the World Bank's role in helping to ensure that the public investment program does, indeed, reflect the appropriate priorities of the authorities. We are also pleased that the program clearly recognizes, and the authorities have explicitly embraced, the need to reduce significantly the fiscal deficit during 1987, that is, the broadly defined consolidated public sector position.

The essential objective of the authorities of restoring confidence in the private sector could be jeopardized if public sector demand for credit is very high during the course of 1987 and beyond as a result of debt servicing requirements and current investment expenditure needs. Therefore, we would underscore the importance of pursuing the fiscal elements of this program, both in 1986 and 1987.

In that connection, we strongly endorse the tax reforms which have been incorporated into this program. Under the previous stand-by arrangement, it should be recognized, progress had been made in taking a number of steps in the direction of a more efficient tax system. However, the reform effort which was put forward in June 1986 is much more comprehensive than earlier efforts and is aimed at raising the revenue elasticity of the system, reducing distortions in economic decision making, and creating a more equitable distribution of the tax burden--all of which could provide greater incentives for and enhanced possibilities of sustained economic growth.

Turning briefly to the efforts under way with respect to the nonfinancial public corporations, I would make three points. First, these corporations have contributed significantly to the fiscal and structural problems of the economy in recent years. Second, a substantial effort will therefore be required over time to correct the problems which exist in this area. And third, while we recognize that initial steps are being made in this direction, it would seem that many details of what actions need to be pursued in this area are still being pinned down. We encourage the authorities to push ahead in their efforts, and we would welcome any information that the staff or Mr. Rye may have about the status of these efforts to develop detailed aspects of the nonfinancial public sector reform.

In the monetary area, two elements of the program merit particular comment: first, the management of traditional monetary policy; and, second, the reforms of the government financial institutions, especially the Philippine National Bank and the Development Bank of the Philippines. It would appear that the challenge for monetary policy during the period ahead lies in providing enough credit to the economic system, particularly to the private sector, to accommodate economic recovery without jeopardizing the important success which has been achieved in the recent past in controlling inflation. If jeopardized, this could undermine confidence and unfortunately offset the strong investment plans of the public sector with weakened investment plans by the private sector. Therefore, we would encourage the authorities to pursue and implement monetary policy with the prudence which has characterized their recent performance. In the past, monetary policy management has been complicated and, indeed, undermined, to a large extent by the need for the Central Bank to provide assistance to the government financial institutions and, more generally, to the entire public sector. In large part, it reflected the run-up of very large foreign debts to finance investments which turned out not to be viable. Broad agreement on the principles to deal with this problem now appear to have been reached. But progress to date has not yet led to complete resolution of many of the difficult problems in this area, and implementation of a strategy to strengthen and improve these institutions largely lies ahead. We would stress the importance of progress in this area. Without it, monetary policy is not likely to be efficient in the medium term, and the entire effort of the Government to strengthen confidence in its economic policy could be undermined.

Turning briefly to the external accounts, in the last couple of years, the current account balance has not given rise to major difficulties due in part, of course, to very weak domestic economic activity. Also, there have been favorable exogenous developments, such as the fall in the price of oil. This should facilitate the resumption of renewed economic growth within the context of a sustainable payments position in the period immediately ahead. It is important to keep in mind that, as trade liberalization moves ahead, the competitiveness and the efficiency of the economy should improve. This would both facilitate and, at the same time, require much better export performance than has been evidenced in recent years, if the payments position over the medium term is to be sustainable.

On the issue of trade liberalization, let me just say that we are pleased that, after some initial difficulties, the authorities have not only renewed their commitment to move ahead in this area but have followed through on their commitment by taking a number of important steps. We would encourage them to continue to persevere in this effort. In spite of the inevitable presence of difficulties that will arise domestically over the medium term, trade liberalization is an essential element of the domestic reform efforts which are under way.

Looking out over the medium term, we see that, as the staff and the authorities clearly recognize, there are considerable uncertainties. The effects of many of the important structural reforms are unclear both in terms of their substance and timing. Exchange rate policy has been rather skillfully managed, we believe, but it will be critical that the exchange rate remain at a competitive level. The staff's medium-term scenario suggests that debt and the debt service ratio could decline during the period ahead. This is a very helpful sign. Yet we do sense that there remains a certain fragility in the medium-term balance of payments outlook. Until we know how the economy will react to much stronger economic growth, it is important that the authorities approach their external position with a degree of caution.

On a related issue, I would like to say that we commend the authorities for the arrangements which have been developed for debt/equity conversions. At the same time, however, we believe that somewhat more favorable remittance limits might add to the attractiveness of this scheme. Also, we believe that, more generally, there will be a need, over time, for a liberalization of direct investment policy to create a better overall investment within which debt/equity conversions can play an important role.

Returning to the medium-term outlook, we have read with some interest the scheme which outlines the authorities' objectives and interests in achieving a sustained high level of real growth over the period ahead. Let me make the following comments in that connection. First, we support strongly the authorities' efforts, represented most clearly by their commitment to structural reform, to achieve high levels of growth during the period ahead. We believe that it is critical that the international financial community be prepared to support those efforts. Nevertheless, it must be recognized that uncertainties will be present, and no arrangements regarding external financing can provide assurance that these growth objectives will be achieved. Indeed, as Mr. Polak and a number of others have pointed out, the development of a medium-term scenario which contains substantial financing gaps may have an adverse effect on confidence, which could work in the opposite direction from that in which the authorities seek to move. Therefore, we would suggest caution in efforts to develop definitive understandings regarding the availability of external finance during the medium term. We are rather confident that the sustained and complete implementation of the program which the authorities have developed will strengthen their creditworthiness even further, both among official and private creditors, and will enhance the prospects that needed finance will be there to support their reform efforts.

In this connection, we understand that this program comes to the Board prior to the discussion between the authorities and the commercial banks concerning rescheduling arrangements for the period of the program. Mr. Rye makes it clear to us that the authorities intend to approach their discussions with the commercial banks with three points in mind--outlined in paragraph 3 of his statement. His concluding comment--"My authorities have expressed a determination to ensure that nothing distracts these negotiations from their proper focus"--does provide me with some assurance. Of course, it is not unprecedented that we consider a program which requires no new money but requires rescheduling prior to certain arrangements with private creditors. However, in light of the authorities' clear desire to pursue their medium-term contingency arrangements, we wonder what certainty there is now about the intention of the authorities and the banks to move ahead expeditiously with the credit arrangements that do need to be made in order for this particular program to work. We would appreciate any information that Mr. Rye, management, or staff may have on the authorities' plans, on the status of their discussions with the banks, and on their intentions to focus on the need first to ensure that this particular program is adequately financed.

Before concluding, let me say briefly that, like Mr. Foot and others, we have noted that the size of the compensatory financing drawing is substantial. Indeed, the Philippines will be able to draw in one day an amount from the Fund that exceeds the entire amount of the stand-by arrangement over an 18-month period. We do not question, at all, that this particular request meets the criteria associated with use of the compensatory financing facility. We are prepared to fully support it, but we believe that this, along with other requests, underscores again the need for us to review more generally our policies and practices with regard to the facility.

In concluding, let me say that we are impressed by the boldness and comprehensiveness of the economic adjustment program which the authorities have not only put before us but have already begun to implement. We believe that they come to the Fund at a juncture when they have a rather favorable environment domestically and a favorable international financial attitude toward their efforts. We hope that they can persevere in these efforts in order to elicit the full support of the international community and in order that their growth and payments objectives can, indeed, be achieved during the period ahead.

Mr. Zecchini made the following statement:

From our previous Board discussion on the Philippines, it was clear that the lack of decisive action in promoting structural reforms in many important areas, such as taxation, public enterprises, and the agricultural sector, was precluding the possibility of placing the economy on a sounder footing. We therefore commend the new administration for the comprehensive set of measures it has already taken and for those it is planning to take in order to promote the structural reforms which should be at the core of any attempt to correct economic imbalances on a durable basis. We welcome the renewed close collaboration between the Fund and the Philippines through the program under the proposed stand-by arrangement, which should strengthen domestic and foreign confidence in the country's economic policies, thereby enhancing the prospects for success of the authorities' adjustment efforts. Due to their importance, we would like to briefly discuss structural policies before examining macroeconomic policies.

Areas in which important structural changes have been implemented include taxation, and the sugar and coconut sectors. As for the former, the merits of the 1986 tax reform package have been well highlighted by the staff in Annex III of EBS/86/222. They relate to the broadening of the tax base and the increase in revenue elasticity which should strengthen revenue sources in a lasting way, as well as to the simplification of the tax system and to the abolition of export duties.

With respect to the sugar and coconut sectors, the monopolistic marketing arrangements which had been responsible for distorting domestic producer prices and for hampering production and exports have been dismantled. Export prospects for these two important goods remain uncertain, however, due to developments in world prices. Moreover, we noted that with respect to the sugar sector, the staff suggests that it would be advisable to lift some charges which are now levied on producers and which unduly burden the sector. Nevertheless, we are confident that, in spite of some lags, the supply response to these structural measures will emerge in the coming years and will be positive.

The process of rehabilitating public nonfinancial corporations and government financial institutions has been initiated. With respect to the former, we note that plans for reorganization have been submitted to the Cabinet. A decision is expected by end-1986 and specific details and timetables of the reforms are to be incorporated in the first program review. While it would have been optimal to have more precise commitments at the moment of the approval of the stand-by program, we understand that the details of this reform, because of their nature, require a longer period to be worked out. We would like to know whether the timetables will be used as performance criteria. In this respect, we would also like more information on what has been the role of our staff and that of the World Bank in preparing the plans which have been submitted by the Presidential Commission to the Cabinet. We also hope that the Cabinet's implementation of the Commission's recommendations for restructuring and privatizing these government corporations will be timely and complete.

As for the government financial institutions, their long-lasting difficulties have burdened the budget and have imposed constraints on the management of monetary policy. We would therefore encourage the authorities to tackle decisively the problems of those institutions in order to make their operations economically sound. In this respect, we are heartened by the agreement which had been reached with the World Bank and by the commitment shown by the authorities in other areas of structural reform.

Turning to fiscal policy, the consolidated public sector deficit is expected to increase to an exceedingly high level in 1986, equal to 7.5 percent of GNP, and then to decrease to 5.2 percent in 1987. We understand that this time profile for fiscal deficits reflects the Government's decision to boost economic expansion through the additional measures taken in the first quarter and the public investment program in the last quarter, while the effects of the tax reform package on revenues will be felt only in the following year. Within these measures, the restructuring of the expenditure side of the budget is extremely important since it would strengthen the capital base and the growth prospects of the economy.

We would, however, like to add a word of caution on the active use of fiscal impulses to stimulate domestic growth. In light of the relatively high public sector borrowing requirement and in consideration of the revised medium-term scenario included in Supplement 1 to the staff report as well as the ambitious growth targets which have been incorporated in it, we believe that a balance should be struck between the need to achieve sustained economic growth and the need to maintain a viable external position. Moreover, prudent financial policies are necessary to strengthen confidence and to make room for private investment.

In our last discussion on the Philippines we expressed the belief that it would be preferable to use the monetary lever, by inducing a reduction of the high real interest rates, rather than the fiscal lever to stimulate the economy. As can be seen from Table 5 of the staff report, the public sector borrowing requirement as well as the domestic component of its financing will remain high until 1988, and this might hamper a reduction in real interest rates, thereby possibly crowding out private investment. Therefore, it is important that the authorities be aware of the fact that the room for maneuvering the fiscal deficit for the purpose of sustaining growth is extremely narrow.

As for monetary policy, the main difficulty of the monetary program lies in the uncertainties surrounding the money demand function and velocity in the short run. As can be seen from Chart 3 of the staff report and from Supplement 1 to the background paper, in past years money velocity and the money multiplier have shown sharp swings caused by shifts in confidence in the financial system. Losses of confidence have induced the Central Bank to intervene in order to support financial enterprises in difficulty, and have favored high interest rates and a shortening in the maturity of public securities. The latter has made monetary management more difficult due to the need to frequently refinance large amounts of securities falling due. These considerations point, on the one hand, to the importance of restoring confidence by rehabilitating the government financial institutions and by following cautious financial policies. On the other hand, they suggest that the performance criterion on the monetary base should be kept under close control. However, if money velocity does not follow the projected path due to deviations from the projected GDP growth, adjustments in this performance criterion will become inevitable.

With respect to the external sector, some favorable external circumstances, such as lower oil prices, lower interest rates, and increases in foreign aid have improved the external situation. Nevertheless, the persistent weakness of world prices for sugar and coconut point to the need to strengthen export diversification efforts and to manage the exchange rate flexibly.

Finally, apart from the systemic problems mentioned by Mr. Foot on the design of the compensatory financing facility, the staff makes a convincing case that all the usual and necessary conditions have been met for granting the Philippines access to this facility. We can therefore support the proposed decision.

Mr. Alhaimus made the following statement:

The gradual slide of the Philippine economy into economic and financial crisis has been traced by the staff to the difficulties that began to appear after 1979, although one may note that the difficulties have been culminating over a much longer span of time. The Philippine economy, as is well known, has been functioning with the assistance of Fund-supported programs almost continuously since 1973. The economic deterioration assumed crisis proportions in 1983 and 1984 as insufficient policies and the eventual loss of control over domestic financial developments inevitably led to a severe foreign exchange shortage, a sharp fall in economic activity and employment, a steep fall in imports, and high inflation that eroded real incomes.

The subsequent adjustment measures which the authorities had to adopt, particularly those taken under the last arrangement with the Fund, have contributed to some improvements, as enumerated in the staff report and Mr. Rye's statement, especially in controlling inflation, but they have not been sufficient to prevent another large drop in economic activity during 1985. More recently, economic performance has been marred by the political upheaval earlier this year that has, on the other hand, also given hope for more fundamental and comprehensive policy measures and a better managed economy.

The new program under consideration is indeed an attempt to effect far-reaching reforms that appropriately aim at reversing the well-entrenched systems of management of past years and reorienting the economy to achieve the long overdue revival of growth after several years of recession and dimming prospects. The broad principles behind present policies seem to offer a consistent basis: they aim at a substantial reduction in government intervention, competitive markets, emphasis on rural development, and a more competitive economy through liberalization. The recent radical changes in the domestic setting and the more favorable external environment, especially in the perception of creditors, together with the new shift in attitudes and policies in the Philippines, should offer a better chance of successfully achieving the program objectives.

The strategy of the program, however, has been based on assumptions and expectations that allow little room for slippages and thus raises doubts regarding the feasibility of its main objectives, particularly the projected rate of growth of output in the coming year. The program gives immediate priority to the resumption of growth in the second half of 1986, with a rise in real GNP growth in the range of 6 percent, moving somewhat higher in 1987. For the second half of 1986 the recovery will be initiated by the fiscal stimulus of a sharp increase in public sector investment and maintenance expenditures. During 1987, sustained growth will depend on the extent to which the authorities will effect structural changes to restore the environment for private investment and growth. It is expected that demand management and structural policies would reduce the financial imbalance of the public sector and thus sustain the recovery of output through the release of resources for the private sector during the coming year.

On the basis of this scenario the question that arises, as has already been observed by other Directors, is whether, by the time fiscal stimulus is withdrawn in early 1987, the structural measures which would have been taken by then and those contemplated through 1987 will be sufficiently credible to generate enough confidence on the part of domestic and foreign investors and thus sustain the recovery that would have depended on fiscal stimulus in 1986. Clearly, it is difficult to envisage whether measures and attitudes, barring any unexpected developments, will in fact synchronize in the desired pattern. This may have led the staff to observe in its appraisal, I think rightly, that the strategy relies critically on a private sector response and that there are risks to the strategy which must be acknowledged and assessed carefully.

More recently, as reported in the supplement to the staff report, the authorities seem to be apprehensive about the uncertainties that may combine to reduce the growth of the economy below the target. They in fact also point to the "heavy dependence of the programmed recovery on a private sector response to the structural reforms, the timing and strength of which cannot be predicted with any certainty and, if substantially delayed, could seriously affect many key parameters of the program." Of course, the authorities underline these and other uncertainties to argue for the establishment of a contingency fund that would safeguard the growth objectives. Nevertheless, these observations, as well as the staff's, seem to point to the delicate basis on which the program's strategy has been based. The feasibility of a contingency fund whose details have not yet been spelled out or negotiated is not yet clear, and thus the only conclusion that can be drawn on the basis of the program's present strategy is that the private sector response will depend critically on the commitment of the authorities to the structural reforms envisaged. The staff appraisal rightly emphasizes this point and finds no alternative other than that the authorities have to be prepared to make the necessary revisions in light of developments in domestic output and export performance.

The prospects in the major areas of the economy, even taking the impact of the program into account, do not seem to permit an easing of the efforts. In the external current account, only a small surplus is projected for 1986, turning to a deficit in 1987. The prospects for exports in 1986 are considered poor, and only a moderate recovery is projected for 1987. This indicates that added emphasis is needed to improve the competitiveness of exports through, inter alia, a competitive exchange rate vis-à-vis the Pacific region.

The public sector deficit is expected to increase substantially in 1986 and will continue at a lower level in the coming two years. It can be acknowledged that finances in 1986 suffered a considerable slippage due to government expenditure. Such a weak fiscal base also calls for persistence in the structural measures now being taken, particularly the tax reform and the steps to improve the finances of public corporations and the government financial institutions, as well as the Central Bank.

A somewhat less worrying area is monetary policy where domestic inflation is now reported in the supplement to the staff report to be at a negligible rate. The task that remains is to ensure that the projected recovery of the economy will not lead to a resurgence of inflation and to address the continuing problem of high real interest rates that can hamper investment.

Looking ahead to the medium-term prospects, one also notes that although the debt service ratio is expected to decline somewhat in the years 1987-91, there will still be a financing gap to be met through exceptional financing as, according to the staff's scenario, external current account deficits will average 2 percent of GDP throughout the period. Again, this scenario will leave no room for complacency in the coming years, especially if the external environment becomes more difficult.

Finally, on the request for the compensatory drawing, I have no problem with the staff's conclusions and can therefore endorse the proposed decision.

Mr. Mawakani made the following statement:

I welcome this opportunity to discuss economic and financial developments in the Philippines, particularly because the staff papers and Mr. Rye's helpful statement provide ample evidence that the new authorities in the Philippines have demonstrated a commitment to move ahead with the country's adjustment process. Like others, I am greatly encouraged by their determination to implement a stabilization and recovery program aimed at addressing the economy's major structural weaknesses.

The agreement reached between the authorities and the staff on the broad policy framework of a renewed adjustment strategy is a significant step toward restoring the confidence essential for the country's economic recovery. In many respects, the measures envisaged and being undertaken under the proposed arrangement are bold and far-reaching. Given the country's circumstances, the measures seem appropriate for enhancing the prospects for the long-term development of the private, rural and export sectors, especially with the sharp reversal in inflationary pressures created by the 1983 financial crisis. I therefore welcome the Philippine authorities' intention to continue to pursue tight domestic financial policies that could strengthen the progress made in the reduction of inflation.

In the fiscal area, I welcome the efforts being made to reduce the public sector deficit as well as the national government deficit during the program period. Of the expenditure measures for achieving the fiscal targets, the reformulation of the 1986 budget priorities to emphasize increased support for rural programs and projects seems appropriate. Regarding the structural reforms aimed at improving domestic resource mobilization, I am greatly encouraged by the bold thrust of the comprehensive tax reform package, especially the withdrawal of exemptions for the nonfinancial public corporations. Given the pervasive nature of the activities of this sector in the economy and the considerable drain on the budget, this is an important step in the overall reform strategy envisaged for this sector. I would encourage the authorities to closely monitor developments in this area if the reform measures envisaged for the public enterprise sector are to be successfully implemented. The Philippine authorities need to persevere with their efforts in this area.

Monetary policy under the proposed program seems to provide a reasonable balance between the need for financial restraint and strengthening the structure of the financial system, on the one hand, and the need to provide adequate funding to support the structural reforms in the sugar and coconut sectors and the rest of the private sector, on the other.

On the external side, a moderate rise in the current account surplus in 1986 and a small deficit in 1987 suggest that the underlying adjustment effort must be firmly continued in order to strengthen the prospects for a recovery in the import-export sector. I welcome the authorities' continued commitment to the pursuit of a flexible exchange rate policy which, if adequately supported with appropriate liberalization policies, could enhance the country's external competitiveness.

I would encourage the Philippine authorities to follow their new program very closely, in view of the ambitious task that they have set. There does not appear to be much room for slippages, and the credibility of the program must be maintained. I support the proposed decisions, including the decision on the request by the Philippines for a drawing under the compensatory financing facility because I find that all the criteria for such a drawing have been met, as fully analyzed in the staff paper.

Mr. Jayawardena made the following statement:

The conclusions in the staff report are solidly based on the comprehensive analysis which is evident from the large number of interesting annexes. I am sure that the authorities have much to be thankful to the Fund and the Bank for, given the assistance they have received. As I have said before, assisting countries in developing good economic policies is an important role of the Fund, one that has been played well in the Philippines.

When we discussed the 1985 program in late 1984, this chair agreed with the proposed adjustment path, but we had some fears of a serious setback to the economy and strongly urged the early implementation of the contemplated structural reforms aimed at improving resource allocation and creating better incentives for the private sector. In retrospect, it appears that our fears materialized; in fact, the economy did suffer a major setback--a loss of nearly 10 percent of GDP for two years--and the structural reforms and supply-side measures, from which we expected offsetting growth impulses, were delayed. These delays were inevitable, given the political changes that took place, and the need for the new administration to settle down and take stock of the situation.

We are heartened to see from the staff papers and Mr. Rye's statement that the authorities are now fully committed to implementing their reforms. We are also encouraged by some of the measures taken so far, such as the dismantling of coconut and sugar monopolies, import liberalization, and tax and tariff reforms. We reiterate that it is in the area of such reforms that the authorities should concentrate their efforts if economic growth is to be integrated into the adjustment program. It is policies in this area that would restore private sector incentives and revive the economy by eliminating the long-standing distortions that have been allowed to emerge. Hence, I shall limit my remarks to this aspect.

First and foremost, no structural reforms or supply-side measures will work effectively unless the exchange rate is determined with the growth and export objectives in mind. Hence, we welcome the increasing flexibility of the authorities in this field. I was glad to learn from Mr. Foot of the gains made by the authorities in employing a Swiss import-export verification firm to check overinvoicing and underinvoicing of imports and exports, respectively. I would go further and say that the authorities should be able to do away with this system by achieving an exchange rate that would eliminate the need to overinvoice and underinvoice.

The second most important requisite will be a tariff reform. We congratulate the authorities for measures taken in this field, especially the most recent progress, and we would urge the authorities to persevere because these changes are vital for future export growth. Trade liberalization can also be achieved by reducing the number of regulatory systems that have developed in the past. While trade monopolies are being dismantled, which we welcome, we would urge the authorities to have a look at the procedural and systemic disincentives that may have grown in the export-import trading system during a long period of preferred access.

Third, we are most impressed by the tax reform package, and we urge the authorities to push hard in this area. The reduction of marginal income tax rates from 60 to 35 percent is sharp and impressive. We hope that revenue collection will improve as a result of the very comprehensive overall tax package, which we fully support. An efficient and elastic tax system is vital to build private sector confidence.

Finally, we fully endorse the planned reform in the public sector. In fact, we would welcome a speeding up of the program of commercialization and privatization, but we understand that this may pose difficulties. Perhaps the best strategy is to permit widespread private sector competition with the public sector enterprises, and without support from the budget so that those public enterprises which cannot live without subsidies from the taxpayer may mercifully either wither away or enter newer and more lucrative fields.

The implementation of these structural reforms would greatly promote the revival of private sector activity and supply-side responses, offsetting the effects of fiscal retrenchment and helping to build confidence. At the same time, the external position could deteriorate as imports grow to support higher growth impulses. Hence, the support of the Fund stand-by arrangement is most appropriate. At the same time, we cannot let good policies fall by the wayside because of inhospitable exogenous factors. Hence the use of the compensatory financing facility to cover an export shortfall that is clearly exogenous is most appropriate. It also demonstrates the great value of the facility in safeguarding adjustment from exogenous developments, especially at times like the present when sluggish growth in industrial countries is jeopardizing adjustment in developing countries. For these reasons, we warmly support the proposed decisions on the stand-by arrangement and the compensatory financing purchase.

A final word on the contemplated contingency fund measure. We see some value in such plans in averting slippages in adjustment. Also, structural reforms take time to yield positive results, and there are crucial early days when some flexibility in financial management will give greater confidence of the attainment of longer-term objectives. We do not think that quarterly reviews by the Fund will be sufficient to achieve this flexibility. The Philippine economy is better managed from Manila than from Washington, D.C. Furthermore, we have said ad nauseum that adjustment without growth and finance is not feasible. A country that suffered a 10 percent reduction in output and income while putting its financial house in order cannot afford to crawl in the years ahead, and at the same time safeguard adjustment. Hence, we think that the proposed contingency financing plans are a novel and useful approach, which will enhance the strength of Fund-Bank supported programs, the feasibility of which we hope the staff will explore in the context of working out so-called "growth-oriented adjustment" in respect of all countries. This is important because we need to dispel some Orwellian cynicism that pervades the air these days--that all countries are treated evenhandedly but that some are treated more evenhandedly than others. We do not subscribe to this viewpoint. But in order to dispose of these stories, we should consider how explicitly to incorporate into, and safeguard, economic growth objectives in Fund-supported programs.

The Executive Directors agreed to resume the discussion in the afternoon.

4. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Huang on the completion of his service with the Board.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/171 (10/17/86) and EBM/86/172 (10/24/86).

5. TANZANIA - STAND-BY ARRANGEMENT - MODIFICATION

Paragraph 2 and the introductory part of Paragraph 4 of the stand-by arrangement for Tanzania (EBS/86/183, Sup. 1) are hereby amended to read, respectively, as follows:

"2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of:

SDR 26.75 million until November 15, 1986

SDR 32.99 million until February 15, 1987

SDR 39.23 million until May 15, 1987

SDR 45.47 million until August 15, 1987

SDR 51.71 million until November 15, 1987

SDR 57.95 million until February 15, 1988.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Tanzania's currency in the credit tranches beyond 25 percent of quota, or increase the Fund's holdings of that currency resulting from purchases of supplementary financing beyond 12.5 percent of quota."

"4. Tanzania will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Tanzania's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of supplementary financing beyond 12.5 percent of quota." (EBS/86/183, Sup. 2, 10/14/86)

Decision No. 8425-(86/172), adopted
October 20, 1986

6. MAURITIUS - 1986 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1986 Article IV consultation with Mauritius to not later than November 3, 1986. (EBD/86/281, 10/21/86)

Decision No. 8426-(86/172), adopted
October 23, 1986

7. PEOPLE'S DEMOCRATIC REPUBLIC OF YEMEN - 1986 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1986 Article IV consultation with the People's Democratic Republic of Yemen to not later than October 29, 1986. (EBD/86/280, 10/20/86)

Decision No. 8427-(86/172), adopted
October 22, 1986

8. JORDAN - TECHNICAL ASSISTANCE

In response to a request from the Jordanian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/86/274 (10/15/86).

Adopted October 17, 1986

9. SIERRA LEONE - TECHNICAL ASSISTANCE

In response to a request from the Sierra Leonean authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/86/275 (10/15/86).

Adopted October 17, 1986

10. YEMEN ARAB REPUBLIC - TECHNICAL ASSISTANCE

In response to a request from the Yemen Arab Republic authorities for technical assistance in the area of tax policy and administration, the Executive Board approves the proposal set forth in EBD/86/272 (10/15/86).

Adopted October 17, 1986

11. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 86/30 through 86/33 are approved. (EBD/86/273, 10/10/86)

Adopted October 17, 1986

12. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/166, Supplement 1 (10/16/86), EBAP/86/244, Supplement 1 (10/17/86), EBAP/86/248 (10/17/86), EBAP/86/249 (10/20/86), and EBAP/86/252, (10/22/86), and by Advisors to Executive Directors as set forth in EBAP/86/248 (10/17/86) and EBAP/86/252 (10/22/86) is approved.

13. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/86/251 10/21/86) is approved.

APPROVED: June 18, 1987

LEO VAN HOUTVEN
Secretary