

LOAN COMMITTEE

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LC/M/86/22
July 28, 1986

Minutes of Loan Committee to consider
PHILIPPINES - Economic Recovery Loan
held on July 17, 1986 in Conference Room E-1208

A. Present

Committee:

Chairman: E. Stern
Finance: J. Woods
Legal: I. Shihata
ERS: C. Michalopoulos
OPS: E. Köpp
Region: A. Karaosmanoglu

Others:

Messrs. Kaji
Golan
Goldberg
Clements
Vorkink
Choksi
Linn
Arrivillaga
Katz
Hicks
Hansen
Keller (IMF)
Smith (IMF)
Mmes. Donovan
Miyazaki
Kafka

DISTRIBUTION

COMMITTEE

Senior Vice President, Operations (Chairman)
Senior Vice President, Finance
Vice President & General Counsel
Vice President, Operations Policy
Regional Vice President concerned*
Vice President, Energy & Industry (for lending
in these sectors and SALs)
Vice President, Economics and Research (for non-
project lending)

OTHERS

Standard (see OMS 9.25 page 7)

*Copy to all other Regional Vice Presidents

B. Issues

1. The meeting was called to discuss the proposal in Mr. Karaosmanoglu's memorandum of July 9, 1986, for an Economic Recovery Loan to the Philippines. The discussion focussed on the main issues raised in the Country Policy Department's memorandum of July 15, 1986.

C. Discussion

Macroeconomic Framework

2. The meeting discussed the Government's plans to embark on an expansionary public expenditure program, the external financing plan, and the implications of the foreign exchange rate policy. The Committee also sought to ascertain the IMF's views on these issues. Regarding the first, the Regional staff explained that the deficit for 1986 was projected to be large (about 4.3% of GNP) because of election-related expenditures early in the year and of serious liquidity problems of Government Financial Institutions (GFI's). Both the IMF and Bank staff agreed on the size of the deficit for 1986 GNP. The staff of the two institutions still had some differences of opinion, however, on the size of the deficit for 1987. The Bank and the IMF will develop a common position based on the findings of two missions which are scheduled to be in Manila during the last two weeks of July. As regards the external financing plan for 1987, the Chairman indicated that the Region will need to determine the country's financial requirements, and its sources of finance, including the scope for further rescheduling of both commercial and official debt. As for the exchange rate policy, another area where there were some differences of opinion between the Bank and the IMF, the meeting was in agreement that the use of reserve targets, as proposed by the IMF, would be adequate to maintain an exchange rate policy consistent with an export-oriented growth strategy.

Tax Reform

3. The meeting agreed that the revenue-raising measures proposed in the program were desirable and that the main issue would be the extent of the Government's commitment to tax reform. The IMF will develop the program of tax reform with Bank staff collaboration.

Trade Reforms

4. The meeting discussed the scope of the trade liberalization program. The regional staff explained that under the new program the Government will complete the trade liberalization measures started under prior SAL's and start a new phase of a longer term program designed to eventually eliminate quantitative restrictions and reduce the maximum tariff rates to 30%. There was agreement on the Region's recommendation to insist, prior to Board presentation, on the completion of the earlier program, in particular on the removal of quantitative restrictions under the previously agreed list.

Public Investment Program

5. The meeting discussed the Bank's role in monitoring the investment program. In this regard the Chairman stated that agreement with the Government on the size and content of the public investment program would

be necessary. The regional staff will need to ensure that this program is consistent with the overall expenditure program agreed with the IMF. Prior consultation with the Bank will be necessary in the case of significant changes in the program's content.

GFI's

6. The meeting discussed the objectives of the program to address the problems of Government Financial Institutions. In this regard, the Region noted that the program for the GFI's, still being developed, would seek, first, to reduce the scope of the Government's participation in the financial system and, second, to help convert any surviving GFI's into viable financial institutions. The Chairman stated that the Region, on completion of appraisal, should outline the Bank's recommendations to address the GFI problem. The mission should seek to reach agreement with the Government on an overall policy statement, defining the Government's role in the financial sector, the scope of its direct participation in the financial system, and the institutional framework to efficiently carry out and/or channel resources for development finance purposes. Consistent with this statement, the mission should seek agreement on the main elements of: (i) programs of institutional and organizational reform for DBP and PNB, or their successor(s), establishing their newly defined functions and range of operations; (ii) financial restructuring plans for the individual institutions, including capitalization plans, and monitorable financial performance targets including appropriate debt/equity and liquidity ratios, elimination of preferential access to Central Bank and other public resources beyond the budget transfers required for the initial capitalization plan, and (iii) a time frame within which a phased program can be implemented. The Regional Staff stated that prior to Board presentation, it expected to have agreement with the Government on suitable framework plans for restructuring/rehabilitating both DBP and PNB. Regarding, the non-performing assets (NPA's), the meeting was in agreement that establishment of a suitable Asset Management Trust would be a condition of the loan. The role of IFC was up to the Government to decide but whatever be the specific arrangements, the Bank would need to be satisfied with them. In addition the disposal of NPA's and life of the Asset Management Trust should have a specified time limit. Finally, concerning the acquired private banks, the Bank should agree on a program for their privatization/liquidation, preferably to be implemented during the disbursement period of the loan.

Tranching

7. The meeting discussed the Region's proposal to disburse the loan in three tranches. Some members of the Committee had reservations about this proposal and suggested instead two tranches. The Region agreed to examine this issue in the light of the program as developed and the nature of actions taken and planned.

D. Conclusions

8. Subject to the modification noted above, the Committee approved the Regional proposal to prepare an Economic Recovery Loan along the lines set out in the Initiating Memorandum. Upon the mission's return, the Region will submit to the Loan Committee an updated and elaborated proposal for approval.