Final Report

Monitoring and Assessment of Tranche 3 of Philippines Support for Development Program II

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Glossary

A.I.D.	U.S. Agency for International Development
ASEAN	Association of Southeast Asian Nations
BAP	Bankers Association of the Philippines
BIR	Bureau of Internal Revenue
BOC	Bureau of Customs
BOI	Board of Investment
BOP	balance of payments
BPB	Budget Planning Bureau
BTr	Bureau of Treasury (DOF)
CBP	Central Bank of Philippines
CP	condition precedent
CISO	Conference of Interisland Shipowners and Operators
CPI	consumer price index
CY	calendar year
DBM	Department of Budget and Management
DFA	Department of Foreign Affairs
DFI	direct foreign investment
DO	Department Order of the GOP
DOF	Department of Finance
DOJ	Department of Justice
DOTC	Department of Transportation and Communication
DPWH	Department of Public Works and Housing
DTI-ITG	Department of Trade and Industry-International Trade Group
EFF	Extended Fund Facility of the IMF
EO	Executive Order of the GOP
ERP	effective rate of protection
ERL	Economic Recovery Loan
ESF	Economic Support Fund
f.a.k.	freight-all-kinds
FCDU	Foreign Currency Deposit Unit
FIA	Foreign Investments Act of 1991
FPPO	Fiscal and Policy Planning Office (DOF)
FSAL	Financial Sector Adjustment Loan
FY	fiscal year
GDP	gross domestic product
GNP	gross national product
GOP	Government of the Philippines
GSIS	Government Services Insurance System
IACSSI	Interagency Committee on the Small Savers Instrument
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association

Glossary (*continued*)

IFG	International Finance Group (DOF)
IMF	International Monetary Fund
IRR	internal rate of return
IQC	indefinite quantity contract
L/C	letter of credit
MAI	Multilateral Assistance Initiative
MARINA	Maritime Industry Authority
MC	Memorandum Circular
MIS	management information system
MLT	multilateral transfers
NEDA	National Economic and Development Authority
NGO	nongovernmental organization
NPC	National Power Company
NPPS	National Planning and Policy Staff (NEDA)
ODA	Official Development Assistance
OP	Office of the President
OPSF	Oil Price Stabilization Fund
OSS	One-Stop Shop (Inter-agency Tax Credit and Duty Drawback Center)
PAAD	Program Assistance Approval Document (A.I.D.)
PDS	Philippine Dealer System of BAP
PEPS	Private Enterprise Policy Support Program
PFC	Project Facilitation Committee
PGDP	price index for gross output
PIDS	Philippine Institute of Development Studies
PITO	Private Investment and Trade Opportunities Project
PTF	Presidential Task Force
QR	quantitative restriction (on imports)
RAMO	Revenue Administration Memorandum Order
REER	real effective exchange rate
SAL	structural adjustment loan
SDP	Support for Development Program (with Stages I and II)
SHIPPERCON	Philippine Shippers' Council
SOW	scope of work
SRRS	Shipping Rate Rationalization Study
SSI	Small Savers Instrument Program
TA	technical assistance
TCC	Tentative Tax Credit Certificate (BIR)
TSC	Technical Support Component of SDP II
USAID	A.I.D. Mission
USG	U.S. Government
VAT	value-added tax

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Preface

This report was prepared for USAID/Manila under the Macroeconomics and International Trade IQC, A.I.D. Contract No. AEP-5451-I-00-2058-0012, a joint venture of Nathan Associates Inc. and Louis Berger International. The project research team, consisting of Dr. John Newton, team leader; Mr. Donald Fritz, transport economist; Mr. Edgar Gordon, macroeconomist; Dr. Rosario Manasan, fiscal economist; and Dr. Benjamin Diokno, policy specialist; performed basic research for the project during May and June 1993 and received additional information during July and early August. The final report was submitted after receiving written comments from the U.S. Agency for International Development (USAID) and the Government of the Philippines (GOP) on the June draft.

The project team would like to thank Philippines Mission Director Thomas Stukel and his staff for their support during the course of this project. Dr. John Chang, Dr. Paul Deuster. Ms. Maria Luisa Panlilio, Mr. Jun Trinidad, Ms. Fely Juanillo, Ms. Cyril Felix, and the remaining staff of the Office of Program Economics were particularly helpful.

Thanks are also due to the Philippine government officials and representatives of the private sector who took the time to meet with the project team and present their observations on the design and functioning of the Support for Development Program II. The names of the Government of the Philippines officials and private sector representatives, as well as the USAID/Manila officers who aided the team are listed in Appendix C.

The views, expressions, and opinions in this report are those of the authors and are not intended as statements of policy of either USAID/Manila or the authors' parent institutions.

1. Introduction and Executive Summary

This report presents the results of the monitoring and assessment of Tranche 3 policy performance under the Philippines Support for Development Program (SDP) II. As demonstrated in detail below, the monitoring team has concluded that the government of the Philippines has complied with the majority of the policy conditions agreed to with the U.S. Agency for International Development (A.I.D.) for the release of Tranche 3, but that certain conditions for at least two of the four policy reform areas had not been met as of August 3, 1993. Chapter 2 of this report describes SDP II and Tranche 3 conditionality in detail, and Chapter 3 assesses both the progress of Government of the Philippines agencies toward fulfillment of program objectives and the economic impacts of the progress toward their fulfillment. The technical support component of the program is the subject of Chapter 4, and Chapter 5 presents the overall conclusions and recommendations of the monitoring team. Appendixes A through C contain background and technical material too detailed for the report text, including the team's information sources, contacts, and methodology. The remainder of this introductory chapter presents a more complete description of the background of the program and the objectives of this study, as well as a summary of the report's results, conclusions, and recommendations.

SDP PROGRAM BACKGROUND

Since 1986, the United States has made two separate grants of Economic Support Funds (ESF) available to the Government of the Philippines through the A.I.D. Mission to the Philippines (USAID/Manila). Serving as balance-of-payments (BOP) support, the first program, SDP I, provided support for general policy reform and private sector-led development. The current program, SDP II, is specifically directed at enhancing the competitiveness of Philippine exports in world markets. The grant agreement defining SDP II provides for US$60 million in transfers, to be disbursed in three tranches, plus funding for background studies. The first two tranches were $18.5 million each and the third is $19.0 million; $3.53 million is provided for ongoing technical support during the term of the grant, and $0.47 million is reserved for evaluation and audit.

The BOP support provided by SDP II was initiated in the context of short-term economic dislocation in the Philippine economy and longer-standing external and fiscal sector policy deficiencies in comparison with competing economies in Southeast Asia. The Philippine economy has been growing quite slowly, with the increase in gross domestic product (GDP) hovering around one percent in 1991 and 1992 and a similar rate probable for 1993. In part, this result is due to the success of the Government of the Philippines' stabilization program in reducing domestic demand and in part to infrastructure problems and the failure of merchandise exports to develop significantly. Although domestic inflation appears to be under control, the fiscal deficit is still problematical: the national budget remains dependent on a narrow base of domestic revenue and official credit.

In addition to progress on the fiscal and infrastructure fronts, the next step in the recovery of the Philippine economy must be the development of export performance. The SDP II policy program provides support for public policy reform fields that promote export development, with policy goals concerning the pricing of exports and the "export enabling" nature of the public sector environment.

REPORT OBJECTIVES

This review of Tranche 3 of SDP II is intended to assess and monitor progress toward the program's policy objectives, including the Government of the Philippines' implementation activities in terms of the program's performance indicators for Tranche 3. The review also addresses the initial economic impacts of policy reforms and the Government of the Philippines' utilization of facilities for technical support and technical assistance (TA) provided under the SDP II grant agreement. More specifically, the objectives of the study are as follows.

- To monitor the progress and assess the initial impact of government policy performance, addressing implementation actions and policy reform indicators specified under the grant agreement.
- To monitor and assess the utilization of technical support and TA provided for under the agreement and to identify any difficulties in the implementation of that support.
- To recommend measures for sustaining economic benefits resulting from policy performance under SDP II and improving utilization of technical support for the remainder of the program.

SUMMARY OF RESULTS

This summary follows the order of the remaining chapters of the report, using the chapter titles for each section, and including a separate section for conclusions and recommendations.

Description of SDP II and Tranche 3

The conditionality required for release of Tranche 3 of SDP II supports the two basic policy goals of the program—competitive pricing for exports and their inputs, and a supportive policy environment for export development—by addressing concrete Government of the Philippines activities in four areas. In addition, the agreement provides for technical support to the Government of the Philippines in implementing and monitoring policy performance. The areas of policy agreement are as follows.

- *A market-determined foreign exchange rate, to be attained by liberalizing the foreign exchange market.* Tranche 3 of SDP II requires that the Government of the Philippines through the Central Bank to (1) broaden participation in the foreign exchange market to other banks and nonbank institutions, (2) revise the accreditation system for foreign exchange brokers and dealers operating in the market, and (3) review the performance of the new off-floor trading system known as the Philippines Dealer System (PDS). These developments would follow on the positive and productive policy reforms carried out during earlier stages of SDP II, including Tranche 2 changes in the interbank trading mechanism and in foreign exchange retention limits.
- *Access to inputs for imports at world prices, to be encouraged by streamlining duty drawback and tax credit systems.* Tranche 3 requires that the length of the processing time for 80 percent of completed applications for duty drawback and value-added tax (VAT)

credit, at both the One-Stop Shop Inter-agency Tax Credit and Duty Drawback Center (OSS) and the Bureau of Internal Revenue (BIR) VAT Division, be reduced to 60 days or less for a period of at least 3 months. Before implementation of the SDP II reform measures, exporters have incessantly complained about the higher costs they have to shoulder as a result of the protracted processing of their claims for drawback and credit of duties and taxes paid on their inputs. The reform of the duty drawback and VAT credit system is intended to make Philippine exporters more competitive with their foreign counterparts by reducing, if not eliminating, these additional costs.

- *Adequate provision of interisland liner shipping services, to be furthered by liberalizing cargo rate regulations.* The third tranche conditionality for SDP II in this field consists of (1) a significant widening of fork tariffs and (2) a reclassification of agricultural commodities. These developments, too, are extensions of earlier SDP conditionality, directed in this case at the Maritime Shipping Authority (MARINA). During earlier stages of SDP II, MARINA had moved more slowly than most other Government of the Philippines agencies responsible for conditionality compliance, adopting the action plan due in May 1992 in October of that year.
- *Efficient financial resource mobilization, to be encouraged by lessening the interest rate impact of public debt financing, through improved management.* In this field, the Government of the Philippines Department of Finance (DOF) was to have designed the mechanisms for the access of small savers to government securities, or alternatively, to have notified USAID/Manila of a decision to discontinue consideration of the program. A program design would ostensibly have been based on extensive earlier feasibility studies, predesign, and general technical assistance on the subject, supported by USAID during earlier stages of SDP I and II, culminating in the proposed bearer savings bond known as the small savers instrument (SSI).

The SDP II grant agreement lists each of these four policy areas in a policy matrix, and each is additionally described in the Program Assistance Approval Document (PAAD) and in annexes to the agreement, as is the technical support component.

Assessment of Progress and Impact of Tranche 3 Conditionality

The monitoring team reached the following conclusions in terms of policy performance under Tranche 3 of SDP II.

- *Foreign exchange liberalization.* The Central Bank has met and exceeded Tranche 3 policy indicators in that the broader foreign exchange market is open to virtually anyone obtaining a municipal business license. The bank has formally stated, in the opinion of its own legal counsel, that Central Bank accreditation is no longer required for nonbank dealers. The few remaining restrictions on foreign exchange sales apply only to the interbank market and largely to capital transactions. The required review of off-floor trading experience has been completed and indicates that the Philippine Dealing System (PDS) is operating smoothly, that the banks have adapted well to the new market, and that major customers have taken advantage of the transparency of the PDS to bargain for reduced bank commissions.
- *Streamlining duty drawback and VAT systems.* In the first year of its operation, the One-Stop Shop exhibited a creditable record. The processing time for duty drawback and tax

credit claims has been reduced significantly. The average processing time of the OSS for tax credit certificates issued between January and March 1993 is 29 days, comparing favorably with the reported average processing time of 1 to 2 years before the establishment of the OSS. The performance of the BIR VAT Division is not as clear-cut, however. On the basis of data received by the monitoring team May 31, the Bureau may have either exceeded or failed to comply with the specific requirements of the SDP II Tranche 3 indicator for VAT credits, depending on how length of processing time is defined. If the processing time is measured from the date the *last required document* was submitted by the taxpayer, then 97.3 percent of the 75 applications "received" in January–March 1993 were processed within 60 working days. By contrast, if the length of the processing time is reckoned from the date the Letter of Authority to Audit was issued, only two of these applications were processed within 60 working days.

- *Liberalization of cargo rates.* MARINA had significantly widened fork tariffs but had not formally reclassified agricultural commodities for shipment, as of August 3, 1993. The agency had stated its willingness to carry out this reclassification, once petitioned by the Conference of Interisland Shipowners and Operators (CISO) and, in the absence of that petition, finally moved to open public hearings on the issue on its own volition in early August 1993. Full compliance with Tranche 3 conditionality, however, requires actual reclassification of the commodities in question, or an equivalent deregulatory action on the part of the agency.
- *Efficient financial resource mobilization.* The Department of Finance, not having adopted a mechanism for the access of small savers to government securities, has notified USAID/Manila that it has decided not to proceed with this program. While this decision is formally in keeping with Tranche 3 conditionality, some analysis of the degree of fulfillment of the basic SDP II objective in this area is called for. That objective—lessening the interest rate impact of public debt financing, through improved management—may not be achieved in the future, regardless of the fate of the SSI, if certain underlying problems with the Philippine fiscal structure are not resolved.

Utilization of Technical Support

Each area of SDP conditionality is accompanied by supporting technical assistance and general technical support in the form of procurement, especially of equipment. Technical assistance consists of background and feasibility studies for each area of required development. In addition, the SDP II grant provides for external monitoring and evaluation of Government of the Philippines and USAID progress, of which this report is an example. Technical support in many of the fields addressed by SDP II has been delayed, in some cases because of contracting delays by USAID and in other cases because of implementation delays by the Government of the Philippines. The support that has been carried out has been productive and well received.

- The Central Bank is to have received procurement support for computer equipment to be used for monitoring the PDS, and USAID is responsible for contracting the required review of the system for Tranche 3. Although contracting for the review is reportedly complete, computer equipment has not been purchased. Studies of the Philippine financial system and the foreign exchange market carried out under earlier stages of SDP II were useful and timely, although limited to the commercial banking system.

- Both the OSS and the BIR VAT Division received technical assistance and technical support under the Technical Support Component of SDP II, with generally positive responses from officials of these agencies. Prospectively, the OSS has identified the need for technical training of their evaluators and processors and also of their MIS personnel. The monitoring team suggests that ongoing support to the VAT Division focus on ways of simplifying their procedures and documentary requirements.
- USAID/Manila has supported several types of technical assistance studies for MARINA and the Department of Transportation and Communication (DOTC), including technical studies and direct administrative support. The studies that address interisland shipping and ocean freight have yielded positive results, but the studies concerning administrative reform have yet to show measurable success.
- In the field of improving the management of public debt financing, SDP II has provided for several studies of prospective financing mechanisms (see Bibliography, Appendix B). These studies have been fairly comprehensive and complete, and have generally been provided in a timely manner, at least in draft form. Had the plans for an SSI been continued by the DOF, the required technical assistance could have provided a final design for a mechanism for small savers to access government securities, or could have provided a marketing plan for the SSI. The resources set aside for such technical assistance could now be used for studies of alternative means of reaching the SDP II basic objectives, if necessary.

Conclusions and Recommendations

In general the results of SDP II, including Tranche 3 policy performance, have been quite positive. The monitoring team recommends continued development in the target areas, as well as specific action to more completely meet Tranche 3 indicators, as follows.

- Performance by the Government of the Philippines in the field of foreign exchange liberalization has been excellent. The Central Bank should maintain its progress in this field and expand it in several ways, first by working out a formalization of foreign exchange liberalization with the IMF—perhaps by declaring Article VIII status. A second means of building on this initial success is for the Central Bank to adhere to its initial objective of making Philippine exports more competitive. To this end the bank should depreciate the peso in an orderly manner, maintaining the levels of confidence necessary to encourage capital inflow to the country. Third, the bank and the BAP should strive to expand the general level of participation in and increase the level of sophistication of the PDS. Finally, the monitoring team suggests that the Central Bank maintain an ongoing informal survey of activities in the nonbank foreign exchange market for statistical purposes.
- In the first 12 months of its operation, the One-Stop Shop performed creditably. The processing time for duty drawback and tax credit claims has been reduced considerably. In contrast, it is not clear that the BIR VAT Division had similar success or met the specific requirements of the SDP II Tranche 3 indicator for VAT credits. To ensure the sustainability of the OSS, the monitoring team suggests that (1) adequate training of new hirees be addressed, (2) procedures for evaluating claims be simplified, (3) greater transparency in the operation of the OSS be observed, and (4) the OSS's estimate of the appropriate size of its personnel and budgetary requirement be reviewed with the end view

of keeping them lean and mean. In order to improve the administration of VAT credit claims, the team recommends that the BIR (and perhaps USAID/Manila, under any future SDP) address the following issues: (1) the centralized issuance of Letters of Authority, (2) the competing claims on the time and effort of revenue enforcement officers, (3) the stringent oversight and review process in evaluating the reports of revenue examiners, and (4) the weak checklisting procedures at the BIR VAT Division.

- Although MARINA has widened fork tariffs considerably, with positive effects on service delivery, agricultural commodities had not been formally reclassified in strict accord with Tranche 3 conditionality as of August 3, 1993. The monitoring team suggests that an alternative approach to this reclassification—addressing first the commodities of most relevance to the export-oriented basic objectives of SDP II—is possible, but must also be enacted formally by MARINA.
- The DOF has decided not to proceed with the SSI and thus need not adopt either a design for the program or a test marketing plan. In the absence of the SSI and its implementation studies, the team encourages the Government of the Philippines, and the DOF in particular, to consider the future necessity of providing some structural means of encouraging lower interest rates on government obligations by using some such competition-engendering mechanism, as the SSI was to have been. Funds for technical assistance set aside for SSI design could now be used for analyzing alternatives to the program.

2. Description of SDP II and Tranche 3

The current Support for Development Program calls for four areas of policy reform, in addition to provision for technical support, evaluation, and audit. A policy development matrix (Table 2-1), outlines the core of the reforms[1] mandated by the program and is the result of joint USAID/Government of the Philippines dialogue, with input from the Multilateral Assistance Initiative (MAI) group of donors to the Philippines. Associated with the SDP II policy reform program is a general schedule of events and reports, outlined in Table 2-2. This chapter describes each of the SDP II policy areas in detail, concentrating on Tranche 3 conditionality. A description of the technical assistance to be provided under the program is presented in Chapter 4. The discussion in this chapter begins with a brief survey of the macroeconomic environment in which the program is set.

MACROECONOMIC POLICY CONTEXT

Earlier reports in this series (see Bibliography, Appendix B) have addressed in some detail the recent history of Philippines macroeconomic policy and its effects, describing its relevance to the SDP program in general and to conditionality design and performance in particular.

In recent decades, and before the current set of reforms, the drawback of Philippine growth policy has been a tendency to overstimulate demand by allowing the fiscal deficit to grow and bank credit to expand too rapidly. To soften the resulting impact on prices, the Central Bank usually allowed the official exchange rate, although nominally floating, to depreciate only modestly, encouraging more imports at relatively stable world prices. At the point at which the inability to borrow, receive aid, and run down exchange reserves made this course of action no longer feasible, an inflation and BOP crisis would occur, accompanied by a marked divergence between the official and black market exchange rates. Stabilization efforts would then be mounted, involving devaluation of the official exchange rate, dampening of demand by standard monetary and fiscal measures, and an end to economic growth. The last such cycle began in 1989, reached the crisis at the end of 1990, and has been in the stabilization phase from early 1991 to the present. All the standard macroeconomic indicators—price and money supply growth rates, levels of short-term interest rates, and the gap between the official and parallel rates—show that inflation is fading and that the economy is becoming increasingly stable. Table 2-3 demonstrates these trends.

[1]Although ESF conditionality broadly defined includes not only those conditions specified in the policy matrix, but also conditions precedent (CP) and special covenants, most such additional conditions under SDP II are strictly procedural and administrative. Those marginally concerned with actual performance are reporting and planning requirements, which are all met as a matter of course during policy reform. Any in-depth analysis of these conditions will be left for a formal evaluation.

Table 2-1. Support for Development Program II
Policy Development Matrix

Policy Objective/Implementation Action	Performance Indicators: Tranche 2	Performance Indicators: Tranche 3
A. Strategy: Competitive pricing of exports and their inputs		
1. Market-determined foreign exchange rate		
Liberalize foreign exchange	Comprehensive review of foreign exchange rules and regulations completed. Retention limits for exporters of their foreign exchange eamings substantially expanded.	Recommendations of the review acted upon, including: • Participation in the foreign exchange market expanded to other banks and nonbank institutions • Revised accreditation system for foreign exchange brokers and dealers operating.
	Off-floor trading among commercial banks initiated.	Review of experience of off-floor trading completed and, if necessary, appropriate adjustments initiated .
2. Access to inputs at world prices		
Streamline duty drawback and VAT credit systems.	One-stop duty drawback center operating effectively.	Length of processing time for 80 percent of completed applications reduced to 60 days or less for at least three months period.
	Procedures for prompt approval of 40 percent of VAT credit claims implemented.	Length of processing time for 80 percent of completed applications reduced to 60 days or less for at least three months period.
B. Strategy: Supportive environment for exports		
1. Adequate provision of interisland liner shipping services		
Liberalize cargo rate regulations	Action plan adopted to liberalize liner cargo rates	Agricultural commodities reclassified. Cargo fork tariffs widened significantly.
2. Efficient financial resource mobilization		
Lessen interest rate impact of public debt financing through improved management	Action program adopted for improving the access of small savers to government securities, including possible use of trust units and/or saving bonds	Mechanism or mechanisms for the access of small savers to government securities designed.

Table 2-2. Comprehensive Schedule of Activities and Events for SDP II

Actions and Events	Objectives	Timing
Tranche Releases		
DOF prepares and submits implementation plans to A.I.D.	To fulfill requirement for the disbursement of dollars from SDP II Special Account and for required band statements	Before tranche release
Government of the Philippines submits a progress report informing A.I.D. of progress achieved	To justify tranche release	At least one week before joint consultations on progress
Joint consultations on progress	To justify tranche release	Three weeks before the desired disbursement date
Grantee furnishes to A.I.D.: (1) a statement of the name, branch, and U.S. Federal Reserve Bank branch number of each bank to which the dollars disbursed are to be deposited with a statement of the amount of dollars to be deposited; (2) an implementation plan; (3) written evidence that the payments made in connection with any prior U.S. dollar disbursement have been made in accordance with the agreement; (4) conclusion of mutually acceptable consultations on the grantee's progress toward the policy objectives and implementation actions of the program	To fulfill conditions precedent to the initial, second, and third dollar disbursements from the SDP II Dollar Special Account	Before desired date of disbursement
Policy Reform Indicators		
Fulfilling Government of the Philippines monitoring and reporting requirements	To fulfill agreed monitoring schedule	Full 3-year duration of contract
A.I.D. and Government of the Philippines conduct reviews of progress and matters affecting the accomplishment of performance indicators, exchanging information and consulting the private sector	To assess satisfaction of policy actions	Continuously for duration of contract
Deadlines		
Program Assistance Completion Date	Parties estimate that all services financed under the grant will have been furnished for the program as contemplated in the agreement	September 30, 1994
Request for disbursements presented to A.I.D.	To obtain agreed funding	No later than 9 months after the PACD or period agreed on in writing by A.I.D.

Table 2-2. *(continued)*

Actions and Events	Objectives	Timing
Grantee furnishes to A.I.D., in satisfactory form and substance, a statement of the name and signature of the person(s) representing the grantee	To designate official representation of grantee	Soon after contract has been signed
Grantee confirms to A.I.D. that agreement is a valid and legally binding obligation of the grantee	To confirm acceptance by grantee of all the terms of the agreement	Before initial disbursement
Technical Assistance		
Technical support elements: technical assistance, policy studies, and training (courses, seminars, on-the-job training, study tours) required to implement SDP II	To maintain continuity of reform efforts of the Government of the Philippines	To be determined. Duration: 3 years, from grant signing to end of contract
DOF acts as lead agency with regard to technical support responsible for preparing implementation plan of technical assistance	To provide support for implementing SDP II objectives	Duration of contract

Table 2-3. Macroeconomic Indicators, 1990–1993

	1990	1991	1992	1993
1. Price increase (percent)	16.2	15.7	8.5	7.8[a]
2. Money supply (M3) increase (percent)	23.1	11.3	11.2	11.6[b]
3. Interest rates on 91-day Treasury bills	29	21	14	11[c]
4. Official exchange rate (P/$)	28	27	25	27[d]
5. Parallel exchange rate (P/$)	30	27	25	27
6. Current account deficit (billions $)	-2.7	-1.0	-1.0	-1.5
7. GNP growth (percent)	-0.3	4.0	0.1	0.5
8. GDP growth (percent)	-0.3	0.7	0.9	1.0

[a] March
[b] February
[c] April
[d] May

Note: Items 1–5 and 7–8 are end-of-period measurements and not averages. Item 6 applies to the full calendar year.

Source: Central Bank for 1990–1992. Monitoring team projections for 1993.

The key trends since the end of 1990 indicated in Table 2-3 are

- The rate of increase of prices and money supply has decreased by one-half,
- Treasury bill interest rates are at one-third of their crisis levels, and
- The parallel exchange rate has *appreciated* by 10 percent.

This encouraging financial performance is not simply the result of decreasing the budget deficit and restraining credit growth, but arises from two other factors as well. First, the extraordinary shortage of electricity, imposing revolving brownouts of 7 to 8 hours per day, has made any substantial increase in production (and resulting demand and price pressure) practically impossible. Second, exchange control liberalization and the disappearance of the gap between the official and parallel markets have together diverted invisible earnings from the parallel to the official market and encouraged the return of substantial capital to the Philippines. The power shortage is a result of serious underinvestment and maintenance of existing facilities, certainly throughout the Aquino administration (1986–1992) and perhaps before. Although a number of smaller generating plants are coming on stream this year, based on a so-called fast track procedure, new base-load plants will not be available for several years. This bottleneck will constrain growth for the foreseeable future.

Concerning foreign exchange trends, when the black market discount on the peso narrowed, overseas worker remittances, tourist dollars, and some formerly hidden commercial transactions began moving through official channels. At the same time, as Central Bank reserves rose, planned exchange control liberalization began to be implemented. This reform, in conjunction with a larger measure of Government of the Philippines financial discipline, has made it feasible for Filipinos with foreign assets and foreigners to arbitrage, taking advantage of Philippine and international interest rate differentials. Investors can convert dollars to pesos, investing in domestic bonds or the Philippine stock market, with the short-run assurance that they can reconvert pesos to dollars at any time. By contributing to the stability of the peso/dollar exchange rate, these movements are self-reinforcing, reducing the risk of devaluation between entry and exit of funds. The inward capital movement has also helped to reduce domestic interest rates by contributing to the supply of investment funds. At the current rate of price increase, real short-term interest rates are about 3 percent annually. At a 10 percent annual inflation rate, which many Filipino investors believe is more likely over the next couple of years, the real rate is less than one percent, the lowest in 5 years.

Philippine economic growth in 1991, measured on a fourth-quarter-to-fourth-quarter basis, was dominated by the restrictive measures taken to fight inflation and the impact on exports, imports, and invisible earnings of the end-1990 devaluation. The consumption component grew by only 0.9 percent, while capital formation declined by 2.7 percent. Exports of both goods and services, stimulated by the devaluation, rose more rapidly than imports, which were impeded by both the devaluation and a 9 percent import levy, designed to help reduce the budget deficit. Recorded net factor income expanded by so much that GNP grew 4 percent while GDP grew at only a meager 0.7 percent. The latter measure is the more accurate representation of true economic growth, since GNP growth includes foreign exchange inflows reflecting the partial disappearance of the parallel market.

During 1992 these tendencies were reversed: domestically oriented economic activity was stronger, whereas the effect of the shift in international trade was to depress growth. Consumption and capital formation rose 2.1 percent and 5.5 percent, respectively. Exports in constant prices declined by 11 percent, reflecting the growing overvaluation of the peso, while imports rose 4 percent for that same reason and because of the lifting of the import levy in the spring of that year. Net factor income declined. Excluding services, which are normally included in the national accounts, only imports of merchandise rose in every category. The Central Bank estimates of import increases at nominal prices can be considered as good relative indicators, since external prices were fairly stable during 1992. Those growth rates—total imports 20 percent, capital goods imports 36 percent, raw materials and intermediates imports 37 percent, fuel imports 15 percent, and consumer goods imports 25 percent—seem to indicate that Philippine business was planning for an expansion in 1992 (although some apparent "investment" may have been capital purchases in response to power shortages).

The outlook for 1993 is modestly positive at this point in the traditional Philippine growth cycle: inflation has abated; interest rates are historically low; investment credit is available; and, to an unprecedented degree, sufficient foreign exchange is available to support investment and consumption requirements, as the peso is practically fully convertible. Nevertheless, there is a sense of uncertainty in the investing community, arising from doubts about the future availability of electrical power, the President's weak political support in the Congress, and the failure to date to conclude a new agreement with the IMF.

The Government of the Philippines is relentlessly optimistic concerning future economic growth, arranging investment projects with groups of foreign investors and emphasizing the advantages of investing in new trade zones, including the former Subic Bay naval base. The administration has projected a growth rate of 3.5 percent for 1993, a figure dismissed as unrealistic by most outside observers. The traditional Philippine public sector management problems—poor public sector project implementation and inability to raise tax revenue as a percentage of GNP—are still apparent to some degree, raising doubts about future power availability and about the prospects of a renewed agreement with the IMF. These doubts will be resolved one way or another in the near future, at which point the Government of the Philippines will face the first concrete test of whether the new foreign exchange regime will avoid the traditional periodic overvaluation of the peso and maintain a continuously competitive exchange rate.

SDP II AND TRANCHE 3 POLICY OBJECTIVES

As outlined in Table 2-1, the areas of policy concern for SDP II are the liberalization of foreign exchange, streamlining of duty drawback and VAT credit systems, liberalization of interisland shipping rate regulations, and efficient mobilization of financial resources for the public sector. Each of these general objectives is linked to specific policy indicators, developed initially in the SDP II PAAD and finally expressed in the grant agreement. As indicated in the following sections, the concrete interpretation of policy indicators has been the subject of periodic communication among Government of the Philippines and U.S. government officials, the most recent example of which is the December 18, 1992, letter of clarification from Undersecretary Romeo Bernardo to USAID Mission Director Thomas Stukel. Since Tranche 3 policy indicators generally follow directly from Tranche 2 performance, the following sections review that performance, in addition to detailing Tranche 3 conditionality.

Foreign Exchange Liberalization

The Tranche 3 policy indicators for SDP II in the field of foreign exchange specify that the Government of the Philippines, through the Central Bank, is to act on the Tranche 2 review of foreign exchange rules and regulations by (1) broadening participation in the foreign exchange market by including additional banks and nonbank institutions and (2) revising the accreditation system for foreign exchange brokers and dealers. In addition, the Central Bank is to complete a review of the experience of off-floor trading (with USAID technical assistance) and initiate appropriate adjustments. Because this set of conditions, together with the related administration and policy implementation, is among the more complex components of SDP II, some background discussion of the issue is required. The following two subsections present a brief description of the former condition of the foreign exchange market and the reforms put in place with Tranche 2 of SDP II.

Market Organization Before Tranche 2

Before early 1991, the Philippine foreign exchange market consisted of three broad, loosely interconnected submarkets:

- The official interbank market, which produced a daily "reference rate";
- The market between banks and their customers, where currency was exchanged at a variety of prices loosely based on the reference rate; and
- The parallel or "black" market.

The reference rate formed in the interbank market was rather artificial, because the volume of transactions determining the rate was small, and the Central Bank dominated transactions. The commercial banks were under instructions from the Central Bank to balance their own demand and supply with as little recourse as possible to the interbank market. Because of this arrangement the bank–customer market was not unitary and transparent, and transaction prices probably diverged more from the reference rate than would be customary in a stable open market. Rationing by extending delivery times or charging special commissions created a family of more depreciated exchange rates to balance supply and demand. These practices bridged some of the gap between the official market and the parallel market, which yielded the most realistic prices of all, because it was the place where residual demand was matched with supply.

The official exchange control system was comprehensive, requiring that all sources of foreign exchange (earnings, transfers, and capital) be converted in the official market and that all payments (imports of goods and services, debt and dividend service, and capital repatriation) be carried out only after authorization. The administration of controls was slow and often discretionary, requiring referrals to the Central Bank for many types of transactions. This system was based on two premises:

- There would always be a shortage of foreign exchange, and
- Supply and demand of currencies were not sufficiently responsive to prices to risk the inflationary expectations and financial burdens, resulting from a sharply depreciating exchange rate, on those entities whose foreign debts greatly exceeded their foreign assets (such as the Government of the Philippines)

For these reasons, the official or reference exchange rate was to be kept as stable as possible, and the greater flexibility of rate changes was to be hidden in the opaque bank–customer market. The major casualty of this system was export activity, which could not count on an exchange rate that remained competitive throughout the growth cycle.

Tranche 2 and 3 Initiatives

The performance targets of SDP II, listed in Table 2-1, were designed to make the exchange rate more amenable to market forces in a way that would clearly benefit exporters. The reforms under the program, for both Tranches 2 and 3, can be summarized as involving three kinds of measures:

1. *Reorganizing the official exchange or interbank market* so that it was more immediately responsive to demand and supply emanating from the economy and less to the manipulation of the Central Bank,
2. *Liberalizing the exchange control system* so that business could react more quickly and fully to economic signals, and
3. As a corollary to the second initiative, *allowing an open foreign exchange market* outside the formal interbank market.

The first category called for a series of actions designed to make both the central and the bank–customer market more transparent and competitive by increasing the number of participants, revising accreditation requirements, and creating a video-based dealing system.

The second category included the expansion of limits within which exporters could retain and use foreign exchange and the general streamlining of controls over payments to make them less costly and cumbersome. The final category of reforms, formally encouraged under Tranche 3, actually came into effect during 1991 and 1992, as the Central Bank ceased to require licenses of nonbank foreign exchange dealers or to sanction exchanges outside the banking system.

Streamlining of Duty Drawback and VAT Systems

The SDP II grant agreement specifies the Tranche 3 policy indicators in the duty drawback and VAT credit area as (1) for the One-Stop Shop Inter-agency Tax Credit and Duty Drawback Center (OSS), "length of processing time for 80 percent of completed applications for duty drawback and tax credit reduced to 60 days or less for a period of at least three month[s]" and (2) for BIR-processed applications under Revenue Administrative Memorandum Order (RAMO) No. 1-91, "length of processing time for 80 percent of completed applications reduced to 60 days or less for at least three months period." These indicators represent a natural progression from the second tranche indicators, which called for the effective operation of the OSS and the implementation of the procedures for the prompt approval of 40 percent of VAT credit claims.

The rationale for the streamlining of the duty drawback and VAT credit systems is to provide exporters access to inputs at world prices. These systems should increase the overall competitiveness of Philippine exporters by reducing, if not eliminating, the capital holding costs associated with the unduly long duration of the processing of drawback and credit applications for tariffs and taxes paid on their raw materials and other inputs.

Before establishment of the OSS May 8, 1992, four agencies, operating under various types of legislation, separately processed applications for duty drawback and VAT credit. The Board of Investments (BOI) processed the availments of tax credit and duty drawback of (1) direct and indirect exporters registered under Executive Order (EO) 226, (2) "internal exporters" under the Order Regalo Program (Letter of Instruction 1355), and (3) local suppliers under the RP-US Military Bases Agreement. The Bureau of Customs (BOC) administered exporters' applications for duty drawback under Section 106 of the Tariff and Customs Code. Pursuant to Section 106 of the National Internal Revenue Code, the Bureau of Internal Revenue (BIR) attended to the VAT credit claims of exporters for taxes paid on their locally sourced inputs (including raw materials, supplies, and intangibles). Finally, as provided under Executive Order 765, the Department of Finance handled duty drawback and tax credit claims of domestic manufacturers selling goods to government projects financed by foreign loans.

While the Tariff and Customs Code and the National Internal Revenue Code both ordain that the processing of rebate claims for duty and VAT be completed within 60 days, exporters reported that actual processing time in these agencies averaged 1 to 2 years. Consequently, their input costs were bloated by (1) the transaction cost of their compliance with the administrative and documentary requirements of the various schemes and (2) the corresponding cost of money associated with their inability to receive and use their duty drawback and VAT credits on time.

Against this backdrop, the government agreed to streamline the duty drawback and VAT credit systems. Under Tranche 2 of SDP II, the government committed itself to ensuring the effective operation of the OSS and implementing procedures for the prompt processing of 40 percent of VAT credit claims.

Liberalization of Cargo Rate Regulations

In 1989, a Presidential Task Force (PTF) on interisland shipping concluded that Philippine government regulation of interisland liner shipping rates had been detrimental to the shippers whom regulation was most intended to help—namely, the shippers of basic agricultural commodities, including grains, fruits and vegetables, and livestock. These several commodities had long been grouped, for the purposes of shipping rate specification, into a "basic" commodity class for which rates were much lower than for other commodities. The PTF concluded that this policy of specifying much lower rates for agricultural commodities had been misguided, and had resulted in an insufficiency of service for these commodities, because they were unattractive to liner shipping operators.

The area of the Philippines most affected by this situation was Southern Mindanao, because it is a highly productive agricultural area that produces large volumes of grains and livestock for domestic shipment, and fruit, vegetables, and fisheries products for both domestic and export trade. Production surpluses in Southern Mindanao have continually exceeded shipments to the area, which meant that sizable proportions of these surpluses could not qualify as "backhaul" traffic when shipped out of the area. This combination of high volumes of agricultural surpluses and low official shipping rates created the following shipment constraints and problems for Southern Mindanao:

- *Inadequate shipping capacity to accommodate large surpluses of corn.* Capacity was inadequate despite the fact that liner shipping capacity was supplemented by tramp (charter) shipping. The unattractiveness of corn to liner shipping operators was only one factor responsible for the inadequacy of shipping, however, because the problem largely resulted from the pronounced peaking of demand, which in turn was the result of a lack of storage and drying facilities in production areas or at the ports of shipment.
- *Unavailability of appropriate capacity for the shipment of fruits, vegetables, livestock, and fisheries products.* Fruits and vegetables need to be shipped in reefer (refrigerated) or ventilated containers; fresh fish require shipment in reefer boxes; and livestock should ideally be shipped in specialized vessels. In the absence of appropriate capacity, Southern Mindanao has had to rely on air transport for its fisheries products and much of its fruit and vegetable shipments, and high-value losses have occurred because of fish, fruit, and vegetable spoilage and livestock weight loss, injury, and death.

As steps to correct these shipment problems for Southern Mindanao, and to a lesser extent for other parts of the Philippines, the PTF recommended

- That "fork" tariffs of ±15 percent of reference points be established and
- That the "basic" commodity classification be abolished, and all commodities in that grouping be reclassified, thereby permitting substantially higher charges to be imposed for their shipment.

In November 1990, the Maritime Industry Authority (MARINA), which regulates interisland liner shipping rates and services, partly implemented these PTF recommendations, and even went beyond the recommendations in some respects. Specifically, the authority

- Established fork tariffs of ±5 percent of reference points;
- Transformed the "basic" commodity classification to a "Class C (basic)" classification with rates much closer to "Class C" than to the former "basic" rates; and
- Totally deregulated rates for commodities shipped in reefer boxes or as "transit" cargoes (interisland legs of international shipments) and rates for livestock shipments

The Interisland Liner Shipping Rate Rationalization Study (SRRS), funded by USAID and conducted in 1991, determined that further liner shipping cargo rate deregulation was desirable, and recommended a program of full deregulation to be carried out during 1992-1996. Early and important facets of this program were to fully implement the PTF recommendations, that is, to institute fork tariffs of ±15 percent, and to abolish the Class C (basic) commodity grouping and reclassify the commodities in the grouping. Regarding the latter issue, however, the SRRS went beyond the recommendations of the PTF by recommending that higher (Class B) rates be imposed when fruits and vegetables are accommodated in ventilated containers.

Although deregulation of interisland liner shipping cargo rates is of importance for ensuring that shipping services are sufficient and satisfactory to meet all demand for interisland commodity movements, it may be useful to point out that the basic goal of SDP II—that is, to stimulate Philippine export growth—requires additional policy initiatives in the Philippine shipping sector, including

1. Increasing the efficiency of interisland shipping services, largely by encouraging and fostering competition.
2. Increasing the adequacy and efficiency of Philippine commercial seaports, partly through government investment, but principally through port privatization.
3. Increasing direct calls by international vessels (including Philippine flag vessels in international shipping) to minimize the cost of transshipment of Philippine exports.

This report is not strictly concerned with assessing the progress the Philippines is making toward achieving the preceding objectives, but it is useful to point out that some progress has been made toward accomplishing all three. USAID is assisting through technical assistance and moral suasion in achieving the first objective.

Improved Management of Public Debt Financing

In the field of financial resource mobilization, the SDP II grant agreement specifies the Tranche 3 policy indicator as the design of a "mechanism(s) for the access of the savers to government securities." This performance indicator is seen as a logical sequence of the Tranche 2-mandated adoption of an action program for improving the access of small savers to government securities, including possible use of trust units or savings bonds, or both. The design of a mechanism for the small savers instrument (SSI) is intended to move toward a more efficient system of financing the government budget, including lower interest rates on public debt. Alternatively, however, the Government of the Philippines has the option of discontinuing the design of an SSI, if it deems that the conditions for its optimal implementation no longer exist. As discussed in Chapter 3, the Government of the Philippines has selected this latter alternative.

The mobilization of additional savings through a mechanism whereby Philippine small savers are provided wider access to government securities, particularly in secondary cities and rural areas, is in direct support of the SDP II objective of improving the efficiency of Government of the Philippines public debt management. During earlier stages of SDP I and II, USAID/Manila supported several studies analyzing the feasibility of a small savers program with the intention of attracting a sizeable amount of savings currently outside the formal financial system. Currently, small savers are effectively excluded from the Philippine government securities market, because Government of the Philippines debt is available only to large, mostly institutional investors, who buy securities through a limited number of authorized dealers. These dealers bid at weekly Central Bank auctions for Treasury bills and notes in denominations of not less than ₱50,000. There is no secondary market for these instruments, but if there were, they would still be far beyond the reach of small savers. Repackaging these bills and notes into secondary instruments or mutual funds would probably not be profitable and may not be perceived as in the interest of current market participants. In such an environment, the only feasible means of mobilizing small savings may be through a well-designed and structured small savers bond, such as the SSI. As earlier studies have indicated, an additional benefit of such an initiative might be an increase in the competition for government debt.

As shown in the Tranche 2 monitoring report (Nathan Associates, September 1992) and in an earlier study of Philippine debt management (Penner, Lamberte, and Diokno, 1992), interest costs are a major contributor to the public sector deficit in the Philippines, representing the largest single expenditure item in the national budget. From 1986 to 1992, interest payments accounted for between 19 and 24 percent of the national budget. The corresponding number was projected to continue in this range during 1993 (at about 26 percent), despite the decline in interest rates. The average rate for 91-day Treasury bills had declined from 21.0 percent in 1991 and 16.0 percent in 1992 to 10.6 percent as of the May 21, 1993, auction. Government authorities have projected an annual average rate of 14.2 percent for the 91-day Treasury bills for 1993. This situation gave rise to the "efficient financial resource mobilization" component of the SDP II policy matrix and its corresponding objective—to lessen the interest rate impact of public debt financing through improved management. The proposed SSI was one means of forwarding this objective, and it remains to be seen whether the Government of the Philippines can fulfill it without this or a similar program of interest rate impact reduction.

3. Assessment of the Progress and Impact of Tranche 3 Policy Reform

The results presented in this chapter indicate that the Government of the Philippines has complied with the majority of the SDP II Tranche 3 indicators inasmuch as its direct authority permits, and that, although full compliance with the indicators by the original June 30 tranche release date was not feasible, a moderate extension of the release date should allow full compliance. The letter and spirit of the foreign exchange liberalization indicators seems to have been met, and the required review of progress has been performed. In the case of the interisland shipping indicators, MARINA has widened fork tariffs significantly and has indicated that it is prepared to reclassify agricultural commodities. The agency also called for public hearings to assess such a reclassification in early August, but had not actually promulgated a reclassification or an equivalent regulatory reform as of August 3, 1993. Concerning the duty drawback and VAT credit claims indicators, the One-Stop Shop Center is operating effectively and within the required parameters. As far as the monitoring team can ascertain, however, the BIR VAT Division failed to process 80 percent of completed applications within 60 days in the January to March 1993 period, although this judgment depends on one's definition of the application period. Finally, the Government of the Philippines has informed USAID/Manila that it will not continue implementing the Small Savers Instrument, thus formally avoiding noncompliance with the Tranche 3 conditionality indicators.

This chapter presents the results of the SDP II monitoring team's analysis of the Tranche 3 policy implementation process, first setting out the results of direct policy implementation—that is, stating whether and to what extent reforms have been accomplished—and then addressing the economic impact of the reforms, to the extent possible. Because only the foreign exchange reforms have had time to affect the economy directly, the team is limited to estimates of prospective future impacts for the remaining items of conditionality.

PROGRESS OF POLICY IMPLEMENTATION

The following four sections address each of the four policy areas specified under SDP II, analyzing policy reform first from the point of view of strict compliance with the program grant agreement and second from the point of view of conformity to the spirit of policy reform, as implied by prior policy dialogue, prior technical studies, and the SDP II PAAD.

Foreign Exchange Liberalization

The monitoring team found that the Government of the Philippines has substantially complied with Tranche 3 policy conditions in the field of foreign exchange, as specified in the SDP II grant agreement, including the required review of the experience of off-floor trading. This section describes the progress of the Government of the Philippines in fulfilling all three Tranche 3 indicators in the field of foreign exchange liberalization, and analyzes current market performance to determine the policy impact to date.

Specific Compliance with Tranche 3 Indicators

Participation in the Foreign Exchange Market Expanded to Other Banks and Nonbank Institutions

If this condition is interpreted to apply to the broader foreign exchange market, including all agents legally participating in the buying and selling of foreign exchange, then the Government of the Philippines, through the Central Bank, has fully complied. The series of Central Bank circulars, beginning with Circular No. 1318, January 30, 1992, and culminating with Circular No. 1389, April 18, 1993, have eliminated practically all restrictions on the sale of foreign exchange by nonbank institutions and have allowed all banks licensed for general service to serve as Authorized Agent Banks (AABs). The few remaining restrictions on exchange dealing apply to AABs only (see next section).

If the condition is interpreted as applying strictly to the video-based Philippines Dealer System, however, it has not been fully met, because the number of participating banks has not increased since the system's initiation in April 1992. Although some nonbank institutions (largely client corporations) may monitor the system, they cannot actively buy and sell through it. Because this system is the creation of the Bankers Association of the Philippines (BAP), however, its membership is not under the direct control of the Government of the Philippines. Resistance to expanding its coverage seems to originate with the current BAP membership, which may deem restricted access to the market to be in their interest.

The monitoring team interprets this indicator to apply to the broader foreign exchange market, not the PDS alone, implying full compliance by the Government of the Philippines.

Revised Accreditation System for Foreign Exchange Brokers and Dealers Operating

Such a system has been operating in effect since early 1992 when the Central Bank lifted ostensible penalties on nonbank foreign exchange dealing and stated that the only requirement for such activity was the standard municipal license. Central Bank Circular No. 1389. April 18, 1993, formalizes this "nonaccreditation" system by bringing all its former statements on the issue into one document and officially specifying the allowable activities of bank and nonbank dealers in foreign exchange.

Review of Experience of Off-Floor Trading Completed and, if Necessary, Appropriate Adjustments Initiated

Such a review has been completed, based on the report by Mr. Cesar Saldaña (see Bibliography, Appendix B), and reaches basically positive conclusions concerning the operations of the PDS, along with several recommendations. The report indicates that the initial technical problems with the operation of the system have been resolved and that its subscribers are using the system effectively. The market behaviors of the Central Bank, the commercial banks, and commercial clients have all evolved to take advantage of the transparency of the system. The commercial banks are taking positions in the market and the Central Bank has become more passive, allowing prices to result from the interaction of market participants rather than from intervention. The report recommends that a technically more sophisticated system be built on current accomplishments.

General Progress of Foreign Exchange Reform

One objective on which the foreign exchange tranche indicators of the SDP II policy matrix are based is the creation of a larger interbank market, enabling a market-determined exchange rate. The key measure to that end was the establishment of the Philippine Dealing System in April 1992—one of the performance targets for Tranche 2. This system allows foreign exchange dealers to work with each other through rates quoted on a video monitor rather than face-to-face on a trading floor. All well-established foreign exchange markets use such systems because they are rapid and more flexible and can reach a larger number of participants.

After an initial experimental period for the PDS, the Central Bank abolished the former trading floor of the Bankers Association of the Philippines, effective August 3, 1992, and provided that all interbank trading transactions, whether spot or forward, would be handled by the PDS. During initial PDS operation, offers to buy and sell were identified by the offeror, leaving them, in the estimation of some, in the same situation as on the trading floor—subject to pressure from the Central Bank for "inappropriate pricing." This identification feature was recently removed.

Before the start-up of the PDS, the banks' ability to participate in foreign exchange trading had been enhanced by Central Bank Circular No. 1327, January 30, 1992, which eliminated an earlier requirement that the banks maintain a balanced position at all times. The new provision allowed long and short positions, not to exceed 25 percent and 15 percent of capital invested, respectively. As mentioned in the previous section, contrary to the strict interpretation of the Tranche 3 indicator calling for "participation in the foreign exchange market expanded to other banks and nonbank institutions," the number of PDS-participating banks has remained the same since April 1992. The situation seems a bit like a stock market, where members may want to keep all the trading in-house, to maximize their own income. In this case, the BAP has resisted allowing new participants into the PDS. Nonetheless, the existence of the system allows other *subscribers* who have substantial interest in foreign exchange trading immediate access to information on price trends in the market, so that they can make more competitive deals (according to participating interbank dealers). The system has made the central exchange market more transparent and, as described in the following paragraphs, much more competitive.

As indicated earlier, a second aspect of the widening foreign exchange market—ensuring that accreditation requirements do not keep out brokers and money changers who wish to enter the business—is also effectively accomplished. According to the department in the Central Bank that administers foreign exchange regulations and issues Central Bank circulars, bank policy now regards foreign exchange trading outside of AABs as legal (see Bibliography, Appendix B, Central Bank Circular No. 1389 and its predecessors). The bank's legal counsel concurs with this interpretation, again according to the regulations department.

A great number of money changers have always operated in the Philippines, but most of their business is believed to have been small transactions involving currency and travelers checks. In addition, there have probably been larger operators in the parallel market whose operations, for various reasons, are not well known. They may have acted as brokers, and even now they are not likely to abandon their traditional secrecy. Although the operations of the various facets of the nonbank market are not strictly involved with Tranche 3 conditionality, outside the fact of its legal existence, the market is relevant to the overall SDP objective of competitive pricing for exports and their inputs. (Any divergence of parallel market rates from official market rates, for example, is an indication that exchange controls are restricting the demand for foreign exchange.) For that reason, the monitoring team carried out a brief informal survey on the nonbank segment of the foreign exchange market, the results of which follow.

The informal survey indicates the entry of several new participants in the sector following the elimination of restrictions on nonbank foreign exchange dealing, including investment houses, finance companies, and even some former bankers. Armed with contacts and a familiarity with the requirements of specific exporters and importers, these individuals and institutions were motivated to enter the foreign exchange market largely because of the perceived arbitrage possibilities. The new participants are involved primarily in turnaround activities—that is, as a rule they do not take positions and thus they carry no substantial currency inventory. In terms of capitalization, these new participants are small compared with the large foreign exchange dealers (e.g., in the Binondo area) who had been operating in the parallel market even before deregulation.

The newer participants in the nonbank market buy foreign exchange from and sell to a confined group of clients with whom they had earlier established relationships in the context of their former activities, for example, investment banking. In contrast, the large foreign exchange dealers corner the inward remittances of overseas workers and service the dollar needs of firms for open importation (importation that does not require a letter of credit [L/C]). As such, the volume of these older participants in the nonbank sector has been hurt somewhat by the recent inroads of the commercial banking sector in the remittance business. With the liberalization of exporter retention limits, there are now exporters who sell foreign exchange to the nonbank sector when the price is right. On the selling side, these individual traders have managed to maintain their own client base.

As in the case of the commercial banking sector, the spread between buying and selling rates in the nonbank sector has declined from 25 basis points to about 10 basis points, and sometimes even lower. At the same time, the difference between the bank rate and the parallel rate has declined. The gap between the rates in the two sectors is now so small that the documentary stamp tax (equal to ₱30 per ₱200 transaction) imposed on bank transactions can affect the foreign exchange purchase decisions of exporters and importers.

In terms of the ultimate effect of making the foreign exchange market more responsive to supply and demand movements, the sweeping liberalization of exchange control regulations is far more important than the formal PDS. The measures can be divided into categories: those concerned with controlling the supply of exchange to the official market and those concerned with limiting demand for exchange. The supply measures are the most essential, because the less the supply the less effective are controls over demand. If exchange controls left unsatisfied demand for foreign exchange in the official market, the peso would depreciate in the free market, offering an incentive for foreign exchange holders to sell. The volume of foreign exchange earnings effectively free of controls, both inside and outside the interbank market, is now so large that the probability of a significant, durable difference between the interbank and parallel markets is small.

In its current state of reform, Philippine foreign exchange regulation treats exchange derived from current earnings differently from that arising from inward investment and lending, at least for the AABs. The sequence of important liberalization circulars in this respect can be divided into two phases, starting in early 1992. Those concerning foreign exchange supply are as follows:

- Central Bank Circular No. 1318, January 30, 1992, freed overseas workers from the obligation to repatriate any part of their remittances through the official market.
- Central Bank Circular No. 1319, January 30, 1992, allowed merchandise exporters to retain 40 percent of their earnings.

- Circular No. 1319 also allowed full and immediate repatriation and servicing for all types of inward investment without Central Bank approval.

The preceding supply initiatives were issued before Tranche 2 and its associated monitoring reports and reviews. The next stage of reform began after those reviews and were codified in Central Bank Circular No. 1353, August 24, 1992, which

- Extended merchandise exporters' retention to 100 percent.
- Eliminated the requirement to surrender any service earnings.
- Allowed free domestic and international trade in gold.
- Eliminated prior Central Bank approval on all export transactions.
- Allowed unrestricted borrowing of foreign exchange of less than one year by the private sector, and allowed inward investments not requiring subsequent servicing from the banking system to go forward without Central Bank approval.

The principal measures liberalizing controls on external payments (i.e., demand for foreign exchange) are fewer, and only the first occurred before Tranche 2.

- Central Bank Circular No. 1318, January 30, 1992, permitted overseas unlimited investments by residents, provided the foreign exchange involved was derived from a Foreign Currency Deposit Unit (FCDU) or another uncontrolled source.
- Circular No. 1353, August 24, 1992, lifted quantitative restrictions on the purchases of exchange for service-related payments.
- Circular No. 1353 allowed outward investment by residents with bank-sourced foreign exchange of less than $1 million per year per investor.

The most recent set of reforms is contained in Central Bank Circular No. 1389, April 18, 1993, which brings together most of the recent pronouncements, circulars, and *de facto* reforms promulgated by the Central Bank, in effect fully liberalizing the foreign exchange market, with the exception of minor restrictions on transactions carried out through the AABs or concerning capital transfers. Of particular relevance to SDP II, Circular No. 1389 abrogates the need for Central Bank accreditation by nonbank foreign exchange dealers, at least in the opinion of the bank's legal counsel, as expressed to the monitoring team in its interviews with the Central Bank regulations department.

In sum, the various reforms and circulars affecting the foreign exchange market, carried out by the Central Bank at least in part as a result of SDP II and the MAI, have had four major results.

1. The peso is convertible *de facto* for all current transactions. Legally a foreign exchange apparatus exists, that the government could, in principle, invoke in a crisis, but in practice holders of foreign exchange can sell to whom they please and buyers can purchase from whom they please in any quantity they require.
2. Concerning capital transactions and other debt payments abroad, the Central Bank has stated that inward and outward investment and debt transactions are unrestricted and need not be registered as long as no foreign exchange from the banking system is required for servicing, repatriation, or repayment. In fact, with the freedom granted by the rules covering current transactions, any other position would be unenforceable. Short-term debt transactions—foreign exchange loans to exporters, importers, domestic manufacturers, and so forth—no longer require Central Bank approval and may be serviced by the banking system.

3. The Central Bank, nevertheless, retains intervention authority for two reasons: it continues to have responsibility for external debt management, and it has to maintain central exchange reserves to intervene in the market when it judges it necessary to moderate exchange rate movements. Therefore, all external loans to all parts of the public sector, and loans to the private sector with public guarantees, will continue to require Central Bank approval, and access to the banking system for capital transactions will be rationed for some purposes.
4. Inward new investment will continue to require the approval of governmental entities other than the Central Bank, and the bank will continue to affect the relative attractiveness of private sector capital flows through its control of monetary policy and interest rates.

The monitoring team concludes that, despite the few Philippine foreign exchange controls that still exist, the peso is convertible for most purposes, and the parallel market has largely lost its role as a semilegal supplier of last resort, except for those who wish to hide their transactions from the authorities. SDP II conditionality in this respect appears to have been met in greater measure than required, at least in spirit.

Streamlining of Duty Drawback and VAT Systems

In the 12-month period between May 1992 and April 1993, the One-Stop Shop's performance was noteworthy in that the processing time for duty drawback and tax credit claims has been trimmed significantly. The degree of successful performance of the BIR VAT Division, by contrast, is not as clear-cut. Judging from data for January–March 1993 received by the monitoring team May 31, the division may have either surpassed or failed to meet the specific requirements of the Tranche 3 indicator for VAT credits, depending on whether the length of the processing time is defined from the date the last document required is submitted or the date the Letter of Authority to audit is issued. It is the opinion of the monitoring team, however, that the date the Letter of Authority to audit is issued is more relevant than the date the last required document is submitted in determining the length of the processing time of applications for VAT credits. The team's discussion of these issues below is divided into observations on conditionality compliance and additional problems and issues in this field of policy reform.

Specific Compliance with Tranche 3 Indicators

One-Stop Shop—Length of processing time for 80 percent of completed applications for duty drawback and tax credit reduced to 60 days or less for at least a 3-month period: On February 7, 1992, President Corazón Aquino issued Administrative Order (AO) 266 creating the One-Stop Shop Inter-agency Tax Credit and Duty Drawback Center. The purpose of the OSS was to facilitate the processing of applications for duty drawback and tax credit under the various pieces of legislation (described in Chapter 2), which were then handled by the BIR, BOC, BOI, or DOF. AO 266 mandated that the OSS issue tax credit certificates within 30 working days of the date of acceptance of completed applications for duty drawback and VAT credit.

The OSS formally began operations May 8, 1992. The audit and verification division of the OSS, which is responsible for the actual processing of the duty drawback and tax credit claims, is divided into four groups: the Duty Drawback Group (or BOC group), the Investment Incentives Group (or BOI group), the Tax Refund Group (or BIR group), and the Government Transactions Group (or DOF group).

In the 12-month period between May 1992 and April 1993, the performance of the One-Stop Shop may be described as creditable. It exhibited considerable success in reducing the time it takes to process applications for duty drawback and tax credit. The OSS has issued 1,395 tax credit certificates amounting to ₱3.0 billion. On the average, the value of the tax credit certificates issued represented 10.7 percent of the value of associated export receipts (see Table 3-1).

Table 3-1. Number and Value of Tax Credit Certificates Issued by the OSS (May 1992–April 1993)

Agency	Number of TCCs	Value of TCCs (₱million)	Value of Exports (₱million)	Ratio TCCs/ Exps (%)
BOI	1,253	1,116.969	17,448.234	6.4
	(74.1)	(36.8)	(61.7)	
BOC	413	1,875.145	10,224.620	18.3
	(24.4)	(61.8)	(36.1)	
BIR	11	4.633	231.776	2.0
	(0.7)	(0.2)	(0.8)	
DOF	13	37.063	394.473	9.4
	(0.8)	(1.2)	(1.4)	
Total	1,690	3,033.81	28,299.103	10.7

Note: Numbers in parentheses represent percentage shares of totals.

Source: OSS.

The BOI group accounted for the bulk of the total number of claims processed (74.1 percent) and the total value of associated exports (61.7 percent) at the OSS. In contrast, the BOC group processed 24.4 percent of the total number of tax credit certificates issued and accounted for 36.1 percent of the total value of associated exports. However, in terms of the value of tax credit certificates issued, the BOI group ranked second to the BOC group because the BOI group's value of tax credit certificates issued to the value of exports ratio was lower compared with the BOC group's (6.4 percent versus 18.3 percent). The BIR and DOF groups each processed less than 1 percent of total number of tax credit certificates issued. However, the DOF group was slightly more important than the BIR group in terms of both the value of tax credit certificates issued and the value of associated exports.

At the same time, the OSS made significant gains in expediting the processing of duty drawback and tax credit claims. Before the establishment of the OSS, processing time was roughly 1 to 2 years. On the basis of January–March 1993 data, the average processing time of claims for duty and tax rebates at the OSS was down to 29 days (see Table 3-2). The DOF group posted the shortest processing time, completing the procedure in 24 days on the average during the period. The BOC group ranked second, with 25.8 days whereas the BOI was third, with 30 days. The BIR group, which took 40 days on the average to process the first 40 percent of the claims filed under RAMO 3-91, had the longest processing time.

Table 3-2. Processing Time of Duty Drawback and Tax Credit Claims of the OSS January-March 1993

	Frequency Distribution				
	0-30 Days	31-60 Days	61 Days and Above	Total	Average Processing Time (Days)
January					
BOI	34	72	1	107	31.8
BOC	17	15	–	32	25.0
BIR	–	–	–	0	–
DOF	–	–	–	0	–
Total	51	87	1	139	30.2
February					
BOI	75	89	1	165	30.4
BOC	27	7	1	35	24.1
BIR	–	3	–	3	43.7
DOF	1	–	–	1	27.0
Total	103	99	2	204	29.5
March					
BOI	129	24	2	155	28.9
BOC	35	8	–	43	27.8
BIR	1	2	–	3	36.3
DOF	1	–	–	1	21.0
Total	166	34	2	202	28.8
January to March					
BOI	238	185	4	427	30.2
BOC	79	30	1	110	25.8
BIR	1	5	0	6	40.0
DOF	2	0	0	2	24.0
Total	320	220	5	545	29.4

Source of basic data: OSS.

Moreover, while only 58.7 percent of the tax credit certificates issued were processed within the OSS's self-set target of 30 working days, 99.1 percent were issued within 60 working days from the date the completed applications were received. Viewed from this perspective, the performance of the various groups followed a similar pattern.

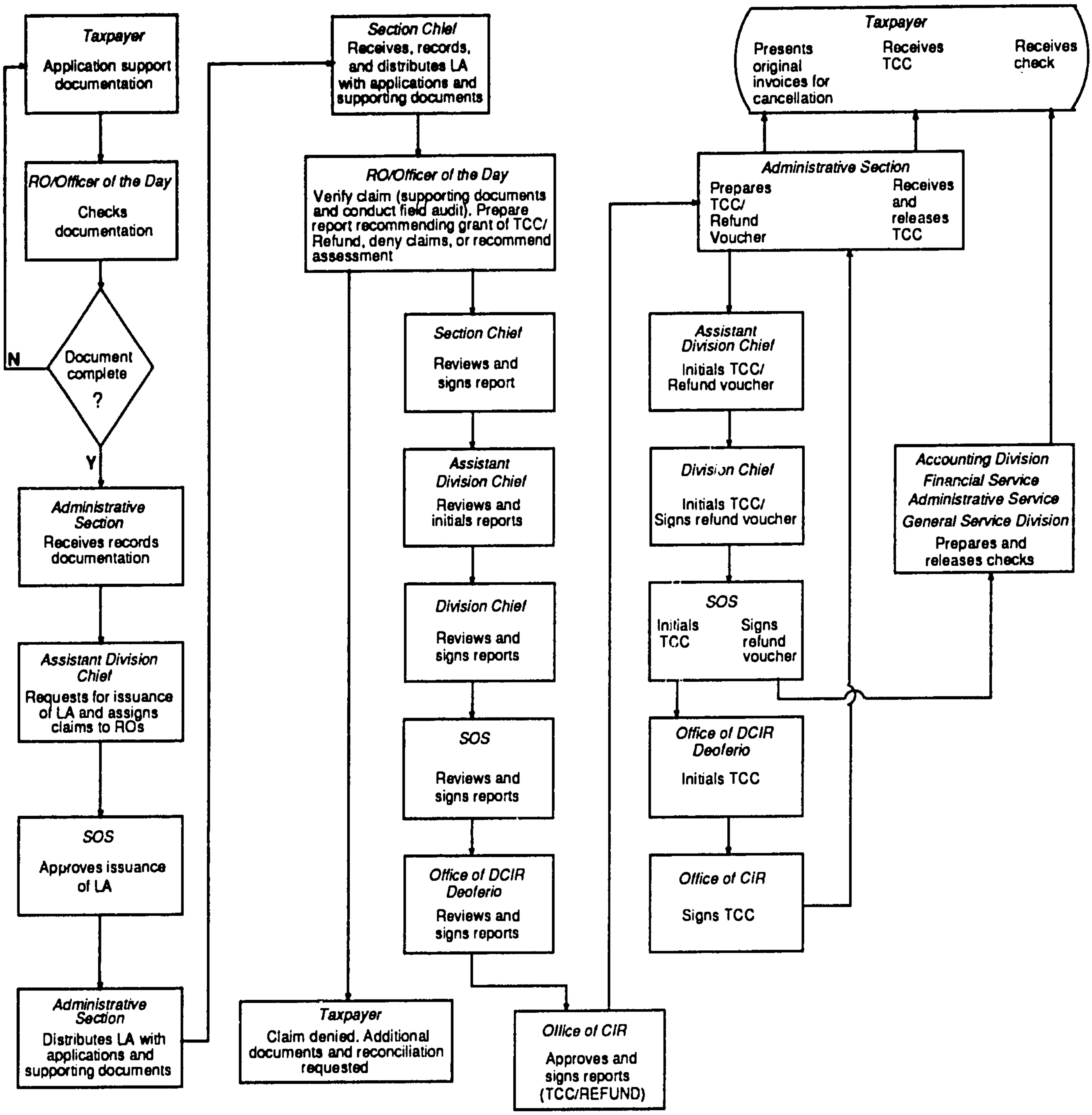
BIR-VAT Division—Length of processing time for 80 percent of completed applications reduced to 60 days or less for at least a 3-month period. The Bureau of Internal Revenue issued Revenue Administrative Memorandum Order (RAMO) 3-91 in August 1991 to speed the processing of claims of exporters for tax credits under the value-added tax (VAT) system. It prescribed guidelines on the issuance of tentative tax credit certificates equivalent to 40 percent of the amount of tax credits claimed to zero-rated or effectively zero-rated VAT payers. The tentative tax credit certificates are to be issued within 20 working days of the scheduled test-checking of 20 percent of input tax credits claimed and 20 percent of export sales reported. The tax credit certificate for the remaining 60 percent of the amount of VAT credit claimed is given after a full audit is conducted.

The BIR VAT Division began implementing RAMO 3-91 in February 1992. However, taxpayers were given the option of applying for VAT credit under either RAMO 3-91 or RAMO 1-91. The RAMO 1-91 governed all previous VAT credit claims before the issuance of RAMO 3-91. It provided that the tax credit certificate for 100 percent of the approved tax credit claim be awarded only after a full audit has been completed.

When the One-Stop Shop was created, the processing of the first 40 percent of claims filed under RAMO 3-91 was transferred to the OSS from the BIR VAT Division. However, the BIR VAT Division continued to administer applications under RAMO 1-91 and the remaining 60 percent of claims under RAMO 3-91.

Between January and March 1993, 75 tax credit certificates for VAT credit claims under RAMO 1-91 were issued by the BIR VAT Division. Bureau officials reported that 97.3 percent of these applications were processed within 60 working days or less from the date the *last required document* was received (see Table 3-3). It should be pointed out, however, that in practice these additional documents are submitted to the BIR at various points between the time of submission of the application for VAT credit and the approval of the tax credit certificate by the Commissioner of Internal Revenue (CIR) (see Figure 3-1). In addition, almost all the applications processed were filed in 1991–1992. Of the 86 applications filed between January and March 1993, none has been completely processed to date. Four of these applications were processed by the BIR VAT Division and passed on to higher authorities for approval, while three other audit cases have been concluded but not passed on, pending additional documentation. Seventy cases are now subject to "stop-clock" measures that were triggered by taxpayers' request for additional time to submit additional documents. BIR officials stressed the difficulties they encounter in ascertaining that all applications passing the checklisting procedure are in fact accompanied by all required supporting documents. First, invoices and official receipts for all purchases of inputs and sales of output form part of the documentary requirements for VAT credit claims. Strictly speaking, the official compiling the checklist should verify that all these documents for credits being claimed are submitted by the taxpayer. In practice, checklist evaluators often simply check that "representative" documents are submitted with the VAT credit application. Bureau officials pointed out that a more stringent evaluation of applications for completeness than that currently practiced would necessitate a full desk audit. Second, they also reported that there are many instances in which VAT payers trying to beat the prescription period for filing VAT credit claims

Figure 3-1. Flowchart for Processing Claims for TCC/Refund (RAMO 1-91)



plead with the BIR to accept incomplete applications to allow them more time to submit the required documents.

Table 3-3. Processing Time of Applications for VAT Credit Calculated from Date Final Documents Were Submitted

Number of Days	January	February	March	Total
0-60	11	21	41	73
	(100.0)	(91.3)	(100.0)	(97.3)
More than 60	0	2	0	2
	(0.0)	(8.7)	(0.0)	(2.7)
Total	11	23	41	75

Note: Numbers in parentheses represent percentage shares of totals. This table refers to TCCs issued from January to March 1993.
Source: BIR VAT Division.

In contrast, the respondents to an informal survey of VAT payers (who have had some experience in obtaining VAT credit) noted that applicants who are applying for VAT credits for the first time are usually unable to submit complete documents because (1) the BIR list of requirements is not clear and (2) additional documents that are not on the list are usually required by the examiners in the course of processing the claim. They pointed out, however, that they do not normally take long to submit additional requirements, stressing that the total time consumed is a minor portion of the total processing time. They also reported that VAT payers also learn as they complete the applications so that incomplete documentation is no longer a problem of VAT payers who have previous experience in filing a claim for VAT credits. The respondents identified various bottlenecks in the VAT credit system, namely (1) scheduling of the field audit, (2) completion of the report of findings, and (3) the review process within the BIR. Two of the respondents reported that they were given indications by BIR personnel that the processing of their claims could be facilitated for a fee.

It is the monitoring team's opinion that, contrary to BIR's contention, the date the *last required document is submitted* is not the appropriate starting point from which to reckon the length of the processing time for VAT credit applications. Ideally, the duration of the processing time should be measured from the date of *acceptance of complete applications*. Since this information is not easily available, the most practical determination of the processing time, given available information, is from the date of *issuance of the Letter of Authority*. Using this definition, only two of the 75 tax credit certificates issued during the period under consideration were processed within 60 working days. Note that even if adjustments are made for delays in processing because of incomplete documents it is apparent from the experience of the VAT payers interviewed that doing so will not alter the picture substantially. Thus, the BIR was not able to meet the specific requirements of the Tranche 3 indicator for VAT credit largely because of certain weaknesses in the system.

If the length of the processing time is reckoned from the date the Letter of Authority to audit was issued, it took the BIR VAT Division 294 days on the average to process the 75 tax credit certificates in question.[2] Only two tax credit certificates issued during the period under study were processed within 60 working days. Moreover, the processing time for 52.0 percent of the total number of tax credit certificates issued exceeded 200 working days (see Table 3-4). Thus, at first glance, it is not quite clear whether the BIR VAT Division has met the specific requirements of the Tranche 3 indicator. Depending on how the length of processing time is defined, the division either exceeded or failed to comply with those requirements.

Table 3-4. Frequency Distribution of Processing Time of VAT Credit Applications Calculated from Date of Issuance of Letter of Authority

Processing Time (Days)	Number of Applications	Percent Distribution
100 or less	7	9.3
101-200	21	28.0
201-300	10	13.3
301-400	10	13.3
More than 400	19	25.3
Undetermined	8	10.7
Total	75	100.0
Average Processing Time	294	

Note: This table refers to TCCs issued from January to March 1993.

Source: BIR VAT Division.

Finally, it should be noted that although 11 tentative tax credit certificates have been issued to date for 40 percent of the VAT credit claims under RAMO 3-91, the BIR VAT Division has not started to process the remaining 60 percent of these claims. The OSS delayed the transfer of the dockets from the OSS to the BIR, pending discussions on the possibility that the OSS will attend not only to the first 40 percent of the claims but also to the remainder. Recently, however, a high-level decision was reached that the BIR will handle the full audit of the 60 percent of claims under RAMO 3-91 as originally planned.

[2]The monitoring team was unable to obtain the dates completed applications were received by the BIR.

Prospects and Outstanding Issues

The OSS has turned in an impressive performance in the first year of its operations. It is imperative that the logistic support necessary to maintain this momentum be made available to the OSS. In this regard, a number of problems have been identified by some government officials. The first concerns the need to maintain the skills level of OSS personnel. The Department of Budget and Management approved 104 out of 110 positions in the OSS's proposed *plantilla* recently. The OSS management has started to recruit personnel. Since December 1992, some 30 people have been hired.

The arrangements for the secondment of personnel from the BOI, BIR, and BOC to the OSS expired in June 1993. Officials of these agencies, particularly BOI officials, indicated that they are not inclined to extend their staff detail to the OSS. These seconded staff are responsible for the actual evaluation of duty drawback and tax credit claims. Initially, the plan was that new hirees would be trained by the seconded personnel for a period of at least 6 months. However, training has started only in the last month. Given this situation, some observers believe that it is not likely that the new staff of the OSS will have the necessary skills when the seconded personnel from the three other agencies leave the OSS by the middle of the year.

The second problem is the need to simplify the procedures and documentary requirements for the processing of claims for duty and tax rebate. Some observers have indicated that the OSS has not progressed from the interim arrangement adopted at the start of its operation, whereby the procedures previously employed in the BOC, BOI, and BIR were also followed at the OSS. Consequently, the gains made to date resulted not so much from a simplification of procedures as from an improvement in interagency coordination as a result of the agencies' being physically housed in the OSS.

The third problem is intertwined with the second. Because procedures have not been sufficiently streamlined, the personnel and budgetary requirements of the OSS appear to be bloated.

The fourth problem is the lack of transparency in OSS operations. Personal contact between the taxpayers and OSS personnel and officials has not been reduced to a minimum. For instance, there are reports that plant visits are made during the checklisting of documentary requirements. Also, the practice of taxpayers "following up" their claims still persists.

Another set of issues is associated with the weaknesses of the BIR VAT system in the prompt processing of VAT credit claims. First, the highly centralized structure of the BIR has resulted in unnecessarily long periods between the acceptance of the completed applications and the issuance of Letters of Authority. Second, the evaluation of VAT credit claims has to compete with the other audit functions of revenue examiners. Third, the review process is very stringent. The revenue examiners' report is reviewed at five different levels, all involving substantive evaluation and re-evaluation. Fourth, the list of requirements does not include all the documents that the examiners need, and the evaluation procedure for checking compliance with documentary requirements appears to be feeble. The checklist evaluator only checks the submission to find out if representative documents are provided by the taxpayer. BIR VAT officials believe that to do more than this cursory checklisting requires a full desk audit. However, a more rigorous review of the documents submitted is necessary if delays in the processing of claims are to be minimized. Also, there might be a need to impose certain limits on the number of times a taxpayer can request to supply or is required to supply additional data or documents. Fifth, there is some evidence that taxpayers prefer to apply for their VAT credits under RAMO 1-91. From May 1992 to April 1993, a period of 11 months, only 36 applications for VAT credits under RAMO 3-91 were received at the OSS. In contrast, the BIR VAT Division received 86 applications in the 3-month period from January to March 1993. As indicated in the Tranche 2 monitoring report, this slow pace of application may be because of the reluctance of taxpayers to subject themselves to two audits under RAMO 3-91 rather than the single audit required under RAMO 1-91. Some VAT payers who were interviewed for this report confirmed this conjecture. They noted that taxpayers are particularly concerned that the current setup, whereby applications under RAMO 3-91 are processed at the OSS while applications for the remaining 60 percent of VAT credit claims will be processed at the BIR VAT Division, increases the likelihood that different examiners will handle the two audits. They point out that such a situation tends to increase their transaction cost. In contrast, other VAT payers reported that because their firms are currently enjoying the income tax holiday and because they are entitled to tax and duty free importation of their other inputs, they do not have the incentive to apply under RAMO 3-91 even if 40 percent of their claim will be released earlier. This situation persists because currently they do not have tax liabilities to which they can apply their tax credit certificates.

Liberalization of Cargo Rate Regulations

Agricultural commodities reclassified and cargo fork tariffs widened significantly. The monitoring team found that the Government of the Philippines has moved to comply with the Tranche 3 policy conditions in this field in that fork tariffs have been widened significantly and that MARINA has called for public hearings for agricultural commodities to be reclassified. Since the agency had received no formal petition from the private sector to this effect as of August 3, 1993, it called for such hearing on its own volition. As of early August, however, formal reclassification had not yet taken place, as called for by SDP II Tranche 3 conditionality.

For Tranche 2 of SDP II, the Government of the Philippines was to adopt an action plan to liberalize interisland liner shipping cargo rates. At the time of second tranche policy monitoring (May 1992, a final report in September 1992) the Department of Transport and Communications had issued its Department Order (DO) 92-587, which established a policy of deregulation in the transport sector and directed its subordinate regulatory bodies to issue guidelines for their respective transport subsectors to this same effect. MARINA, as the regulatory body for the maritime transport subsector, had responsibility for producing guidelines for that subsector and for preparing the required rate liberalization action plan. The monitoring report noted that MARINA had not yet carried out these tasks as of September 1992. MARINA, however, with its Memorandum Circular (MC) No. 67, May 1992, had widened the fork tariffs to +10 percent and -15 percent of reference points, thereby permitting shipping operations and shippers a great deal of flexibility in the negotiations to establish service charges for individual shipments.

In October 1992, MARINA prepared both the rate liberalization action plan required under SDP II for the second tranche and the rate and franchising liberalization guidelines, in compliance with DO 92-587. The latter was issued as MARINA's MC 71, which permits, *inter alia*, the reclassification of commodities in the Class C (basic) grouping as required for SDP II Tranche 3. Under Philippine law, however, it appeared that any commodity reclassification could be effected only on petition by shipping operators for such reclassification, after which an open hearing must be held. The Conference of Interisland Shipowners and Operators (CISO) had expressed its intention to petition for abolishing the Class C (basic) commodity group and reclassifying all commodities currently in the group. As of August 1993, however, CISO had not petitioned for such reclassification, for which reason MARINA moved for public hearings *motu proprio*. Nevertheless, conditions for the third tranche had not been formally met as of early August 1993.

In addition, certain elements of existing Philippine law may, in fact, be an impediment to the entire transport deregulation program, and it may be necessary to amend or replace the Public Service Act if interisland shipping deregulation is to proceed. A bill to accomplish this goal for all transport modes is in Congress, but a law that would deal specifically with the economic regulation of the ports and shipping subsector appears preferable.

Despite the impediments of existing law, it has now been more than 4 years since the PTF determined that the creation of a special commodity category for basic agricultural commodities was a misguided policy and recommended that the category be abolished. It has been nearly 2 years since MARINA agreed to abolish the category and reclassify the commodities involved. Although MARINA appears to be committed to a program of cargo rate and service deregulation, and to the SDP II-required commodity reclassification, the monitoring team concludes that formal compliance with SDP II Tranche 3 conditionality requires further concrete action by MARINA—either reclassifying agricultural commodities as described or promulgating equivalent deregulatory action.

Improved Management of Public Debt Financing

Mechanism(s) for the access of small savers to government securities designed. During the draft stages of this report (May 1993), the monitoring team concluded that the small savers program appeared to have suffered a serious setback with the recent change in the presidency of the Government of the Philippines.The conditions for the release of Tranche 3 of SDP II has not been met for this policy area, in that no SSI mechanism has been designed and prior preliminary designs have not been adopted. Subsequently, the Government of the Philippines notified USAID officials of its intention to discontinue plans for the SSI entirely, thus avoiding a formal violation of SDP II conditionality.

Interviews with government officials in May 1993 revealed many of the reasons for the discontinuation of plans for the small savers instruments program. In his meeting with the monitoring team in late May, then-Acting Secretary Leung mentioned four reservations concerning the prospective SSI: (1) the security of marketing, holding, and redemption of the instrument; (2) its financial feasibility in light of prevailing interest rates; (3) the appropriate denomination of the bond; and (4) its most appropriate means of marketing and distribution. Each of these issues was covered to some extent in the preparatory studies for the SSI, but the first two undoubtedly require further attention, perhaps in the context of either a test marketing or a design effort.

Perhaps the most important of these reservations, in terms of SDP II objectives, was the financial feasibility of any SSI offering. For the government to benefit from such an issue, the gap between the (real, positive) interest rate paid to purchasers and the Treasury bill rate the Government of the Philippines was already paying would have had to be large enough to yield an interest payment savings greater than the cost of issuing the new instrument. Although that gap was quite large at the inception of SDP II, it has been substantially reduced, with inflation between 8 and 9 percent and Treasury bill rates of about 10.6 percent, as of May 21, 1993. At such levels, DOF officials had cause for concern and preferred to carry out a cost-benefit analysis along the lines suggested in prior SSI studies before making a "go-no-go" decision. Such analysis, whether or not it was carried out formally, apparently indicated little or no benefit from a prospective SSI.

ECONOMIC IMPACTS OF POLICY REFORM

Most of the expected impacts of SDP II policy reform are yet to be felt, since the reforms have only recently been implemented. Certain effects in terms of the foreign exchange market are evident, however, and the effects of duty drawback and VAT claims can be roughly estimated. The monitoring team recommends that all estimates at this point be interpreted as prospective and illustrative. More reliable estimates may be possible during the final evaluation of SDP II.[3]

Foreign Exchange Liberalization

The economic impact of foreign exchange liberalization is felt on the balance of payments, on the exchange market and exchange rate and, through the exchange rate, on the rate of growth. The latter topic is discussed in detail under Macroeconomic Policy Context, Chapter 2.

Balance of Payments Impacts

The SDP-supported reforms of the Philippine foreign exchange system have allowed an improvement in the BOP situation even in the face of a continuing merchandise trade deficit. Table 3-5 describes the current account of the Philippine balance of payments for 1991–1993(Q1). The change from 1991 to 1992 can be summarized as an increase in the merchandise deficit of $1.5 billion, matched by an equal increase of the surplus on invisibles, with no change in transfers and, therefore, about the same current deficit. The merchandise deficit continues to increase in the first quarter of 1993, but the continuing rise of Central Bank reserves through March suggests that net invisibles and capital inflow were more than sufficient to pay for that deficit.

Table 3-5. Current Account 1991–1993 ($billions)

	1991	1992	1993
Exports	8.8	9.8	2.4
Imports	12.1	14.5	3.8
Trade balance	-3.2	-4.7	-1.3
Invisible receipts	5.6	7.5	NA
Invisible payments	4.3	4.6	NA
Balance	1.4	2.9	NA
Net transfers	0.8	0.8	NA
Current account balance	-1.0	-1.0	NA

Source: Central Bank.

[3]Earlier reports in this series have used the PIDS/NEDA econometric model to estimate the prospective impacts of SDP policy reform, and the formal evaluation of SDP I used that model for current estimates of impact. Since no new data on reforms are available and the model has not been updated recently, the team elected not to perform such estimates this year. The final evaluation should probably include econometric estimates, however, since they were included as justification for the program in the SDP II PAAD.

The current account reflects not only liberalization of the foreign exchange market but the effects of the stabilization policy in general, with the resulting high interest rates that made holding Philippine pesos more attractive. Table 3-6, tracing the evolution of several accounts of invisible earnings, transfers, short-term capital, and private investment, indicates how trends in these components have reinforced each other. The first full year of stabilization was 1991, marked by high interest rates and the practical disappearance of the gap between the official and parallel market. Liberalization of the market was concentrated largely in 1992, when prior Central Bank approval of short-term investments, servicing, and repatriation were removed.

Table 3-6. Selected Balance of Payments Accounts, 1990–1993 ($millions)

	1990	1991	1992	1993[a]
1. Personal Income[b]	1,203	1,649	2,222	2,489
2. Personal Remittances	262	329	315	347
3. Tourism	466	571	944	1,086
4. Balance 1+2+3	1,631	2,549	3,481	3,922
5. FCDU withdrawals[c]	643	866	1,263	1,364
6. Short-term capital	369	350	72	-
7. Balance 5+6	662	1,235	1,613	1,436
8. New direct investments	-	130	234	NA
9. Reinvested earnings	-	34	42	NA
10. Portfolio investment	-	227	566	NA
11. Balance 8+9+10	-	391	842	NA
- Outflows	-	117	526	NA
= net capital inflow	-	174	326	NA

[a]Central Bank projections as of April 1993.
[b]Transfers of wages and salaries of overseas Filipino workers.
[c]"347/547" accounts.

Source: Central Bank.

Item 4 in Table 3-6 totals the major categories of invisible earnings and personal transfers. The large increase from 1990 to 1991 indicates that the stabilization program, which sharply reduced the trade deficit, also raised interest rates, increased dollar inflows and, as a result, closed the gap between parallel and official exchange rates. For the subsequent period, liberalization is not as important a motivation for individuals sending remittances and tourists converting foreign currency for expenses. It could also be argued that the rapid rise in overseas workers' transfers of their earnings through official channels is really a consequence of the absence of a premium in the parallel market and the effort that the commercial banks have made to offer convenient facilities for transfers.

The impact of liberalization is clearer in Items 5–7 in Table 3-6. The short-term capital line is responsive to interest rate differentials between Manila and Hong Kong, and its decrease reflects the fact that Manila interest rates (corrected for exchange rate risk) are now less subsidized and are moving toward international levels. The FCDU withdrawal line indicates increasing conversions from dollars into pesos, reflecting new-found confidence in the peso, brought about in part by liberalization allowing the peso to be reconverted into foreign exchange for a wide range of purposes. Line 7, the sum of these two items, thus shows an increasing inflow of short-term foreign exchange to the Philippines. The effect is stronger in the balance shown in Item 11 of Table 3-6, which reflects longer-term investments, particularly the portfolio component. Inflow more than doubles from one year to the next, but outflow also rises sharply under the category "capital withdrawn from the Philippines." This trend may represent several years of applications for repatriation, whose holders took advantage of the new liberalization to effect transfer.

The most defensible interpretation of BOP trends from 1990 to 1993 is that the stabilization program set the stage for foreign exchange market liberalization by providing an initial surplus in the overall balance of payments, which restored confidence in the peso and allowed reform to go forward without creating fears of unsustainable capital outflow. Liberalization reinforced confidence in the peso and stimulated more capital inflows.

That period may be coming to an end. The decrease in internal interest rates has made arbitrage between different currency investments less profitable, the immediate impact of liberalization has now been absorbed, and most invisibles are now flowing through official channels. The trade deficit keeps rising, however, and the complaints of exporters about increasing noncompetitiveness are growing stronger. The peso is now more likely to depreciate than appreciate, so that the Government of the Philippines will face a test of the new system in a different atmosphere.

Exchange Market and Exchange Rate Impacts

The general objective of the reforms proposed in this area under SDP II was to liberalize exchange trading by broadening the interbank market, reducing the role of the Central Bank in order to realize a true market-determined exchange rate. To determine the extent of such effects, the topics discussed in this section are (1) changes in the volume of foreign exchange traded, (2) changes in the extent and means of Central Bank intervention, (3) changes in the Bank's role as regulator, and (4) changes in commercial bank behavior in the interbank market and with their customers. The trends the team identify are an increase in the volume of transactions, a decrease in spreads, and a decrease in the rate gap between the interbank and the parallel markets. Table 3-7 indicates sales and purchases in the interbank market for 1991 and 1992 and the first four months of 1992 and 1993.

The main trends indicated in Table 3-7 are that transaction volume has increased rapidly; the Central Bank is still the main purchaser of dollars, although its share has dropped from about 85 percent in 1991 to about 60 percent currently and during the second half of 1992; and the Bank has left sales of foreign exchange almost entirely to the commercial banks. Transaction volume increased because the overall balance of payments was in surplus from early 1991 onward. The commercial banks bought what was required for their own clients, but were still forbidden by Central Bank regulation in 1991 from maintaining an overbought position; foreign exchange assets and liabilities had to exactly balance. After that restriction was lifted at the end of January 1992 (Central Bank Circular No. 1327), the commercial banks were allowed to take overbought or long positions in dollars, up to 25 percent of their capital. Their share of purchases then increased.

Table 3-7. Trends in Foreign Exchange Transactions, 1991–1993 ($billions)

		Purchases			Sales	
		Total	CB	cbs	CB	cbs
1.	1991	2.2	1.9	0.3	0.1	2.1
2.	1992	3.9	2.4	1.5	0.2	3.7
3.	1992[a]	0.940	0.811	0.129	0.013	927
4.	1993[a]	1.340	0.780	0.560	0.036	1,304

[a]First four months of year indicated.
Note: Total purchases equal total sales.
Source: Central Bank.

The Central Bank policy of regularly buying dollars prevented the exchange rate from appreciating even more than it has throughout most of this period. From a level of more than 27 ₱/$ in late 1991, it moved up to 24.7 ₱/$ in September 1992 and then declined to 25.5 ₱/$ until the beginning of April 1993. During the course of 1992, the bank *sold* exchange in any significant quantity only when the rate exceeded 26 ₱/$ in May and June. Over the past 2 months, the peso has been depreciating. It moved from 25.5 ₱/$ on March 29 to 26.3 ₱/$ one month later and to 27 ₱/$ by mid-May. The bank entered the market briefly when the rate passed 26 ₱/$ but made no attempt to stop its continued movement. There have been a variety of explanations for these trends: the drop of Treasury bill rates, which was partly caused by the decision to borrow less; the rumor that the bank is deliberately pushing the rate down to accommodate exporters; and, of course, the speculation of delayed repatriation and accelerated purchases of foreign exchange building around these rumors. The bank's intervention in the market in April and May suggests that it was trying to steady the exchange rate at around 26 ₱/$ but the rate fell back to 27 ₱/$ when the bank faced resistance. In the month up to mid-May, its operations have almost entirely been on the selling side.

The increase in transaction volume, the firm establishment of video-based trading, the initiation of the PDS (which officially replaced the old trading in August 1992), and the Central Bank's willingness to cooperate in the spirit of reform, all have transformed the role of the commercial banks. They are now deeply involved in the interbank market instead of trying to conduct business on a limited broker basis—balancing customers selling foreign exchange to those wishing to buy it.

The monitoring team has been informed by Philippine commercial bankers that, within the interbank market, the normal 20-basis-point spread in the past between buying and selling rates has dropped to five points in many cases, with exact prices depending on whether the banks are approaching their regulatory ceilings. The existence of the PDS screen, with the market opened all day instead of a half-hour as before, has made prices more transparent and available to the larger customer market. Some large foreign exchange customers are subscribers to the Telerate or monitoring service of PDS, and some now employ former traders to help them obtain the best prices. Customers are now moving around from bank to bank looking for bargains, and the tight relationships of the past, for many of them, are fading.

As a consequence, fee income from foreign exchange transactions is falling, unless a bank is competitive enough to make on volume what it is losing per trade. In addition, the partial shift from peso to dollar finance for exporters has reduced income, because absolute interest rates, and therefore the point spreads in that market, are smaller. As a result of its poor performance in this environment, one of the smaller banks is being sold, an indication of how competition has increased. Obviously, customers have benefited from a lower cost of doing business.

Summing up the economic impact of foreign exchange trading reforms:

- Exchange control liberalization has been most effective in stimulating capital inflow, now that a timely exit is guaranteed.
- The Central Bank has taken a less dominating role in interbank transactions, allowing more scope for the commercial banks to make prices without intervention.
- The commercial banks have become much more competitive, reducing their fees and commissions to the benefit of exporters and importers.
- All of this has occurred in the benign atmosphere of a balance of payments surplus, whereas, for the future, it is more likely that an overall deficit will arise again as the trade deficit continues to widen. The problem of exchange market management, including monetary policy, will then become more complex for the Central Bank.

Streamlining of Duty Drawback and VAT Systems

In terms of global effects, it would be difficult to isolate the impact of the streamlining of the duty drawback and VAT credit systems under SDP II from the impact of other policy reform measures, such as the liberalization of foreign exchange regulations on exports. What is clear, however, is the micro-level impact of a more expeditious system of duty and tax rebates on the input costs of exports. Assuming that the processing of duty drawback and VAT credit claims would have taken 1 year if the OSS had not been established (a conservative figure by industry estimates), and based on the average Treasury bill rate of 14 percent in 1992, the net savings to exporters arising from the prompt issuance of the P3 billion tax credit certificates from May 1992 to April 1993 is equal to P354 million. The following table gives an estimate of savings in capital-holding cost as a result of the establishment of OSS. Of course, this estimate is preliminary, but more complete calculations must await a more extensive record of OSS and BIR activities in this field.

Before establishment of OSS:	Value of TCCs: P3,033 million
(multiplied by)	Interest rate for 1 year: 14%
(is equal to)	Capital cost: P424.6 million
After establishment of OSS:	Value of TCCs: P3033 million
(multiplied by)	Interest rate for 2 months: 1.23%
(is equal to)	Capital cost: P70.8 million
Net Savings:	P353.8 million

Liberalization of Cargo Rate Regulations

Rate deregulation for the interisland shipping industry, in the form of widened fork tariffs, appears to have begun to have positive results, although more time will be required for increased opportunities for competition to significantly alter service and price structures and for those changes to be measured. MARINA officials and members of the USAID-supported technical assistance teams have monitored one region of the country (General Santos in Southern Mindanao) carefully since the beginning of rate deregulation, however, and believe that new operators are entering the market as a result of rate flexibility.

Similar effects are expected as a result of the reclassification of agricultural commodities, once that reform has been implemented.

Improved Management of Public Debt Financing

Because the SSI was not adopted, much less implemented, there can be no economic impact of the program. A small announcement effect could have existed, but is also unlikely. In terms of economic impacts of alternative financing mechanisms, the more relevant current questions are

- What events have caused the trends leading to the discontinuation of an SSI program by the Government of the Philippines?
- Are these trends likely to continue?
- What are the likely impacts of *not* having an alternative public sector financing mechanism?

Trends in current interest rates paid by the Government of the Philippines are relevant to the final rejection of the SSI program by government in that a favorable interest rate environment made the adoption of a small savers program less necessary. Interest rates for 91-day Treasury bills had fallen from a high of 28.6 percent as of January 1991 to a low of 10.6 percent as of May 21, 1993. As indicated in earlier sections of this report, this reduction can be attributed to a host of factors: downward trends in interest rates in major industrial countries, a declining domestic inflation rate, a weak domestic economy, a decreasing fiscal deficit, and increasing inflows of capital from abroad. Another factor responsible for declining interest rates is the Central Bank's announcement and subsequent implementation of a gradual reduction in the reserve requirement, from 25 percent in 1992 to 22 percent by July 1993, with a further reduction to 20 percent scheduled by the end of 1993. Altogether the reserve requirement reductions will have released some ₱15.9 billion into Philippine capital markets during 1993, with a consequent significant downward pressure on interest rates of all types. Rate declines due to all these factors made the eventual adoption of a small savers instrument less necessary as a public financing mechanism and thus an unlikely possibility.

For several reasons, however, this declining interest rate environment is unlikely to last much longer. It appears certain that Government of the Philippines economic planners do not foresee a further decline in domestic interest rates though 1994. For purposes of fiscal planning, government authorities project that the average 91-day Treasury bill rate will be 14.2 percent in 1993 and 13.5 percent in 1994. If so, public sector interest rates and the large interest bill will continue to crowd out private sector investment in employment-creating activities and essential public sector activities such as education, health, and physical infrastructure. At the same time, increasing public sector investment needs because of recent natural disasters and poor infrastructure planning will lead to an increased requirement for domestic public sector borrowing. In the future, there may be a renewed need for a program such as the SSI.

While the observed declining trend in Treasury bill rates has given finance officials in the government reason to discontinue plans for an SSI, the underlying fiscal problems that led to high interest rates to begin with may still remain. Interest payments, in absolute terms and in relation to GNP, remain large (see Tables 3-8 and 3-9: National Government Debt Service Expenditures, 1986–1994 and National Government Debt Service as a Percentage of GNP, 1986–1994). In addition, infrastructure spending as a percentage of GNP has been consistently low during the last 6 years. The observed slight rise in capital spending during the last 2 years may be misleading, in that the figures reflect the massive spending necessary to partly restore the damages to the country's physical infrastructure brought about by the series of natural calamities such as earthquakes, volcano eruptions, and floods in 1990 and 1991. Spending for new infrastructure remained low during the period. As mentioned earlier, the Government of the Philippines Midterm Growth Plan (see Bibliography, Appendix B) projects both increasing public sector investment and higher interest rates on government debt.

Several alternative means of addressing these fiscal problems are available, including perhaps a future revival of a small savers instrument. Other more fundamental structural alternatives are presented in Chapter 5.

Table 3-8. National Government Debt Service Expenditures, 1986–1994 (Pmillions)

Payment	1986	1987	1988	1989	1990	1991	1992	1993[a]	1994[a]
Interest payments	21,612	36,905	45,865	54,714	71,114	74,922	79,571	78,630	81,226
Domestic	15,681	24,224	32,183	41,032	53,323	56,347	63,113	57,453	56,242
Foreign	5,931	12,681	13,682	13,682	17,791	18,575	16,458	21,177	24,984
Debt amortization	6,449	32,789	25,455	28,503	35,232	45,504	29,651	30,560	36,586
Domestic	1,979	24,150	12,408	16,760	14,952	29,298	9,898	8,068	12,502
Foreign	4,470	8,639	13,047	11,743	20,280	16,206	19,753	22,492	24,084
Total	28,061	69,694	71,320	83,217	106,346	120,426	109,222	109,190	117,812
Domestic	17,660	48,374	44,591	57,792	68,275	85,645	73,011	65,521	68,744
Foreign	10,401	21,320	26,729	25,425	38,071	34,781	36,211	43,669	49,068

[a]These figures are projections.

Source: Bureau of Treasury.

Table 3-9. National Government Debt Service as a Percentage of GNP, 1986–1994

Payment	1986	1987	1988	1989	1990	1991	1992	1993[a]	1994[a]
Interest payments	3.6	5.5	5.8	6.0	6.6	5.9	5.8	5.2	4.7
Domestic	2.6	3.6	4.0	4.5	5.0	4.5	4.6	3.8	3.3
Foreign	1.0	1.9	1.7	1.5	1.7	1.5	1.2	1.4	1.5
Debt amortization	1.1	4.9	3.2	3.1	3.3	3.6	2.2	2.0	2.1
Domestic	0.3	3.6	1.6	1.8	1.4	2.3	0.7	0.5	0.7
Foreign	0.7	1.3	1.6	1.3	1.9	1.3	1.4	1.5	1.4
Total	4.7	10.4	9.0	9.1	9.9	9.5	8.0	7.2	6.9
Domestic	3.0	7.2	5.6	6.3	6.3	6.8	5.3	4.3	4.0
Foreign	1.7	3.2	3.4	2.8	3.5	2.8	2.6	2.9	2.9
GNP, Nominal [PM]	596,276	673,130	795,159	913,843	1,076,210	1,261,654	1,370,378	1,510,000	1,712,700

[a]These figures are projections.

Source: Bureau of the Treasury.

4. Utilization of Technical Support

Under its technical services component (TSC) the SDP II grant agreement provides for support to the Government of the Philippines for both technical assistance and procurement in each of the four prescribed policy fields. In large part, the general objectives of programmed technical support are being met to at least some extent in all four fields, despite contracting delays and failures to contract in two of the areas. In no case have contracting delays led to noncompliance with Tranche 3 policy indicators.

FOREIGN EXCHANGE LIBERALIZATION

The Central Bank is supposed to have received technical support of three types under SDP II: studies of the foreign exchange market, procurement of computer equipment and related technical assistance for the monitoring of the PDS, and a review of the performance of off-floor foreign exchange trading, that is, operation of the PDS. The second type of support—procurement of computer equipment—has not been provided, reportedly because of contracting delays on the part of A.I.D. A series of reports providing the first type of support, produced by IMCC and PIDS (see Bibliography, Appendix B), has been submitted to USAID, with the final version, *Foreign Exchange Liberalization in the Philippine Economy*, dated October 1992. Finally, review of the operation of the PDS has been completed (Saldaña 1993).

The SDP-supported reports on liberalization of the foreign exchange market reviewed by the monitoring team concentrated on the formal interbank market, to the virtual exclusion of the parallel market in foreign exchange. Although the latter market was only semilegal at the time the reports were being prepared—and reliable, relevant information concerning it was and still is very difficult to obtain—the operations of nonbank foreign exchange dealers are of some interest for Philippines monetary and development policy. The volumes and spreads in the parallel market and the gaps between its rates and the formal market rates can help the Central Bank gauge the effect and effectiveness of its policies. Despite the continuing secrecy characteristic of this market, the monitoring team recommends that future studies of the foreign exchange system address its operations, at least in an informal manner.

STREAMLINING OF DUTY DRAWBACK AND VAT SYSTEMS

The OSS and the BIR VAT Division received a number of technical assistance interventions under SDP II. First, the OSS secured four computers under the Technical Support Component, which came at a critical time, when budgetary and logistics support from the government was still uncertain. Second, senior officials at the OSS were sent on a study tour in New Zealand to become familiar with the operations of similar institutions overseas. Likewise, the Chief of the BIR VAT Division went to Indonesia to observe VAT administration. Third, the OSS was given technical advice on the design of its management information system while the VAT Division is receiving similar support with respect to improvements in VAT administration. Fourth, the OSS was also given support for local training. Specifically, a self-evaluation seminar for the first 6 months of operations was conducted with support from the SDP II TSC.

Prospectively, the OSS has identified the need for technical training of its evaluators and processors and also its MIS personnel. The monitoring team suggests that ongoing support to the VAT Division focus on ways of simplifying procedures and documentary requirements.

LIBERALIZATION OF CARGO RATE REGULATIONS

USAID-supported technical assistance under SDP I and II in connection with interisland shipping has consisted of the Shipping Rate Rationalization Study (SRRS) conducted in 1991 and the Philippine Sea Transport Consultancy (PSTC), which is ongoing as of May 1993. The PSTC consists of two studies—the Liner Shipping Route Study (LSRS) and the MARINA and Philippine Shippers' Bureau (SHIPPERCON) Study (MARSH).

The SRRS achieved its objectives, first, by specifying a desirable program for liner shipping rate deregulation and, second, by identifying the additional studies required to establish a firm foundation for shipping sector improvement. The latter identification included drafting terms of reference for seven studies, including the LSRS, the MARSH study, and five other studies focusing on the port system, agricultural product shipment, passenger services, maritime safety, and manpower development. The SRRS recommendations for rate deregulation provided the basis for MARINA's October 1992 action plan and, to some extent, also for MC 71.

Soon after the September 1992 mobilization for the LSRS, MARINA's MC 71 was issued, essentially anticipating some of the recommendations of the study, and making desirable the revision of the study's scope of work in order that it might better assist the implementation of liner shipping franchising liberalization. These changes in the scope of work were made in early 1993. As a result of these changes, the LSRS has now drafted for MARINA an MC 71-A, which provides more precise language for some of the definitions and guidelines of MC 71, and includes some new service liberalization and rate deregulation initiatives. Among these, and most important for achieving the basic SDP II objective of export development, is the full deregulation of rates for perishable commodities accommodated in ventilated containers. The LSRS has also prepared a draft ports and shipping economic regulation bill, which would permit shipping rate deregulation and franchising liberalization to proceed. The LSRS will, as a result of the SOW revision, also draft a successor memorandum circular to MC 71 and 71-A, which will include those items of MARINA's action plan for deregulation that have not yet been incorporated in guidelines for the interisland shipping subsector. A memorandum circular will also be prepared for ferry services.

Besides these new study tasks, the LSRS is conducting an analysis of the adequacy of liner shipping service throughout the Philippines, and in May 1993, delivered to USAID and MARINA a report on the liner services of Southern Mindanao. It is too early to determine how well this report and other aspects of the study may have been done, or whether the study will be completed by its revised deadline of December 1993.

The basic objective of the MARSH study is to strengthen MARINA and SHIPPERCON, primarily to enable the two agencies to effectively monitor the adequacy of interisland liner shipping services (and, in the case of SHIPPERCON, other services as well). The MARSH study, which started off slowly, has also had its scope of work revised. The one important accomplishment of the MARSH study, as of May 1993, has been the involvement of the Department of Trade and Industry (DTI) regional office in assisting in developing the domestic objectives and functions of SHIPPERCON. Otherwise, there is no evidence as yet that the study has had any impact on MARINA functions, objectives, procedures, or effectiveness.

IMPROVED MANAGEMENT OF PUBLIC DEBT FINANCING

Under Tranche 2 of SDP II, the Department of Finance requested and received a study on small savers instruments with the following objectives: (1) to devise a workable way to further the mobilization of small savings, particularly in the secondary cities and rural areas; (2) to provide a positive real rate of return on these savings; (3) to encourage the promotion of a savings mentality; and (4) to make available to the Government of the Philippines a new pool of funds that could be used to finance the public debt at rates less than those for Treasury bills and with a term of more than one year. During the last review in this series (see Bibliography, Appendix B), the monitoring team reported that the interagency committee on the SSI had discussed the results of the study with the principal authors and generally agreed with the recommendations in the study. After changes in the top management team at the Department of Finance, however, the status of the interagency committee organized to oversee the implementation of the small savers program became unclear. Before the decision to discontinue the SSI program, the committee had not met formally since November 1992, nor had there been any formal DOF action on earlier SSI studies. The current technical assistance available under Tranche 3 of SDP II, therefore, was not provided. Presumably the resources allocated for this purpose are now available for the consideration of alternative means of improving the management of public debt financing in the Philippines.

5. Conclusions and Recommendations

The monitoring team for Tranche 3 of SDP II has concluded that conditionality for this stage of the program appears to have been fully met for two of the policy areas involved but only partially met for the other two areas. In the field of foreign exchange liberalization, the Government of the Philippines has not only fulfilled Tranche 3 conditionality but has also advanced further than required, assuming that the "expansion-of-participation" requirement applies to the broader foreign exchange market and not to the PDS alone. In the field of duty drawback and VAT credits, the Government of the Philippines has met the conditions applying to the One-Stop Center, and has promised initial data indicating that it has met the conditions applying to the BIR VAT system. MARINA has partially complied with its conditionality in the cargo rate liberalization field, having significantly widened fork tariffs. The agency has not reclassified agricultural commodities for shipping, although it has held public hearings for the purpose of doing so. Finally, the Government of the Philippines, through the Department of Finance, has decided not to proceed with the design of a small savers instrument for government securities.

The monitoring team recommends a series of improvements in the interpretation and implementation of Tranche 3 conditionality before release of the tranche. These recommendations are presented below, along with a more detailed statement of conclusions. Also, the team recommends several additional developments for future government reform programs or versions of the SDP, or both.

FOREIGN EXCHANGE LIBERALIZATION

The general objective of SDP II reforms in this field was to create a more market-determined exchange rate in order to promote exports and reduce the costs of conducting international trade. The instruments embodied in the performance indicators for Tranches 2 and 3 were designed to (1) increase the role, resiliency, competitiveness, and prominence of the interbank market so that the exchange rate determined in this market would be more realistic and (2) loosen controls on the surrender and purchase of foreign exchange so that exporters could respond to market forces more easily.

With regard to the first goal, establishment of the Philippine Dealing System transformed the interbank market. Not only has volume increased but also the commercial banks are now much more important participants, using the market as a source of supply, a place to put surplus exchange, and a place to take positions. Although the number of direct trading participants in the PDS has not increased, several of the more important foreign exchange users are participating indirectly by subscribing to Telerate so that they are aware of the best prices at all times. By obliging banks to compete for business, the Central Bank and the PDS have lowered the spread between buying and selling rates to a fraction of their former levels.

With regard to the second goal, first, the liberalization of exchange surrender requirements has been so extensive and controls on outward payments are now so slight that the peso has become *de facto* convertible. Because there are no restrictions on the receipt and holding of foreign exchange, the effective barrier between the parallel and official markets has disappeared. Second, anyone with a business license can set up as a dealer and, presumably, many others can arrange purchases and sales informally.

Therefore, the monitoring team judges that performance of these indicators under SDP II has been excellent. The Government of the Philippines has done even more than it pledged to do. The team heartily recommends that this liberalization be maintained and expanded. Further improvements in the management of the Philippines foreign exchange sector are possible and could be carried out under future versions of the Support for Development Program or general government policy reform programs. In particular, the underlying rationale for exchange market reforms—that of making export prices more market-determined and competitive—can be furthered by additional measures. Such improvements could include the following reforms.

- The new *de facto* convertibility of the peso should be made a legal commitment.
- The Central Bank should pursue a more aggressive policy to depreciate the peso in the context of a serious export promotion policy.
- The bank and the BAP should broaden and develop the foreign exchange market into a more sophisticated and accessible means of trade.

In addition to these reforms, the team also recommends that the Central Bank maintain an ongoing informal survey of the nonbank foreign exchange market for statistical and comparative purposes.

Convertibility of the Peso as a Legal Commitment

By eliminating controls over the supply of foreign exchange, the Central Bank has made remaining controls over demand largely irrelevant, at least for current market activities. Even so, the *de jure* continuation of the control apparatus suggests to market participants, especially exporters, that another crisis could undo the bank's newfound policies of liberalization. Such an episode—which precisely because of the current liberal policies would result in a more thoroughgoing reversal than those of recent years—could lead to a correspondingly more severe reversal of economic growth and export activity.

In order to make the current policies of liberalization more credible, and thus to avoid a reversal of the sort described above, the Government of the Philippines should declare to the IMF that it is prepared to be treated as an Article VIII country—meaning that it will employ only monetary and fiscal measures or devaluation to close BOP deficits, not foreign exchange controls. Few countries in East Asia, outside of Japan, have taken this step, although most have strong, flourishing economies. It is precisely because the Philippines has one of the poorer records of foreign exchange management and economic growth that it should take such a step, to attract the investors it needs to produce and promote exports.

Aggressive Exchange Rate Valuation Policy

In addition to investor confidence in the stability of the exchange rate, a sound export promotion policy depends on a competitive exchange rate. This rate for the peso has seldom been competitive enough to even maintain the Philippines' share of its export markets, except briefly when a crisis has driven down the currency's market value. Ironically, investor confidence is currently leading to an overvaluation of the peso, and if the declaration of Article VIII status is accepted at face value by the market, the problem of overvaluation would become even more acute, as the inflow of investment funds increases.

In large part, the outcome of these events depends on future Central Bank policy. The bank remains the major participant in the exchange market, with large reserves and control over short-term interest rates—the instruments required for helpful intervention. The question is whether the Central Bank has modified its historical view of the exchange rate as a symbol of internal stability, to one of an instrument of export promotion, and is prepared to lead the rate by market intervention to more competitive levels.

Broadening and Development of the Interbank Market

The PDS has worked out rather well. The volumes traded have increased sharply and the spreads between buy and sell orders have decreased. As the report reviewing the PDS described in Chapter 3 indicates, however, the PDS is still a spot dollar/peso market: there are no futures quotations, and other major currencies such as the yen are not traded against the peso. To become a full-fledged foreign exchange market, these and other facilities will have to be added, as soon as staff training and investments in technology permit.

More important than the range of instruments traded on the market, however, are the issues of the number and type of participants in the PDS. The original underlying problem with the earlier BAP "trading floor" was the dominance of the Central Bank. Although its share of market transactions has fallen significantly, it is still the dominant participant, not only by virtue of its size but because it is the legal regulator of the other participants—the commercial banks. The Central Bank appears to have no interest in expanding the number of participants—since its influence would be diluted—nor do the commercial banks—who have already seen their transaction margins fall because of increased competition.

Expanding the formal market, to include nonbank corporations that would like to operate mainly for their own account, would make for market action much more independent in relation to the Central Bank than that of the commercial banks. The counter argument—that such a market would produce less stable prices—is precisely what *should* happen if the goal is to produce more realistic, market-determined prices. Of course, many of the companies that could join an expanded PDS are probably already carrying out foreign exchange transactions, because there is now no prohibition on buying and selling one's own foreign exchange, but they could do so more efficiently within the PDS market. In that case, their transactions would more directly affect the foreign exchange prices of the central market.

In summary, what has been accomplished by the Government of the Philippines to date in terms of foreign exchange liberalization are the first steps in a process that must now be completed and consolidated in order to further the goal of making the Philippine economy more competitive for exports and general production.

STREAMLINING OF DUTY DRAWBACK AND VAT SYSTEMS

In the first year of its operation, the One-Stop Shop has performed creditably. The processing time for duty drawback and tax credit claims has been trimmed significantly: the average processing time between January and March 1993 was 29 days. This performance compares favorably with the reported 1 to 2 years average processing time before the establishment of the OSS.

In contrast, judging the performance of the BIR VAT Division in processing VAT credit claims is not as clear-cut. The BIR reported that 97.3 percent of the tax credit certificates it issued in January-March 1993 were processed within 60 working days from the date of receipt of the *last required document* and claims that it has, in fact, exceeded the SDP II's Tranche 3 indicator for VAT credits. However, it is the monitoring team's assessment that such a position is not valid. Ideally, the processing time should be measured from the date of *acceptance of a complete application*. Since this information is not easily available, the most practical determination of the processing time, given available information, is a measurement from the date of *issuance of the Letter of Authority*. Using this definition, only two of the 75 tax credit certificates issued during the period under consideration were processed within 60 working days. Interviews with VAT payers indicate that adjusting these figures for the delays because of incomplete documentation will not significantly alter the conclusion that the Bureau failed to meet the specific requirements of the Tranche 3 indicator.

To ensure the general sustainability of the OSS, the monitoring team suggests that (1) OSS institute an adequate training program for new hirees, (2) the procedures for evaluating claims be simplified (see below), (3) greater transparency in the operation of the OSS be observed, and (4) the OSS estimate of the appropriate size of its personnel and budgetary requirement be reviewed with the view of keeping the shop "lean and mean."

To improve administration of VAT credit claims, the team supports recent initiatives to transfer the processing of these claims to the OSS. Recent information from OSS officials (received by the team August 11, 1993) indicates that an agreement has been reached within the DOF. However, the formal transfer and its details have yet to be worked out. Nevertheless, OSS officials are optimistic that the shift will be effected by September 1, 1993.

OSS officials have informed the evaluation team that initial discussions between the One-Stop Shop and the Bureau suggest that the BIR will continue to process the claims that it has received before the transfer; that is, the OSS will start with a clean slate. The plan to date is for the OSS to eliminate the two-stage procedure whereby firms apply under RAMO 3-91 to get 40 percent of the claim initially and apply under RAMO 1-91 to obtain the remaining 60 percent of their claim. Thus, OSS officials intend to merge these two stages into one, such that firms simply apply for VAT credits once and after these have been processed they receive 100 percent of the approved amount. However, OSS proposes to follow the procedures prescribed by RAMO 3-91. This implies that the evaluation of the claim will involve test checking of a given portion of input taxes and export sales claimed rather than conducting a full audit. The extent of the test checking is not yet established. At the same time, OSS officials are hoping that some 15 to 20 document evaluators from BIR will be seconded to the OSS to complement the staff already there.

If the preceding plan is followed, it is likely that processing of VAT credit claims will proceed more rapidly than before because the current bottlenecks in the BIR system will have been avoided. First, the list of documents required under RAMO 3-91 is well-defined and appears to be well-understood by VAT payers. Second, the proposed procedure will not necessitate the issuance of a Letter of Authority to audit because full audit will not be required. Third, corollary to this, the actual evaluation of the claim can be accomplished within a shorter time frame than before because only test checking will be required. Fourth, the overly protracted BIR review process at the BIR will no longer be followed. Fifth, the integrity of the system is supposed to be ensured by the post-audit mechanism that the OSS has reportedly put in place in recent months. It is too early at this stage to evaluate the adequacy of the OSS post-audit system. It should be emphasized, however, that a good post-audit system is essential because the proposed arrangement for processing VAT credit claims is a radical departure from that followed under RAMO 1-91.

If the OSS follows the procedure under RAMO 1-91, that is, conduct a full audit as part of the evaluation of the VAT credit claims, it is less likely that the transfer will result in significantly shorter processing time because most of the problems under the BIR system will persist, for example, delays in issuance of the Letter of Authority. Also, it is critical that the BIR agrees to detail more staff to the OSS. Moreover, if RAMO 1-91 procedures are adopted, some of these staff should be revenue examiners and not just document processors.

LIBERALIZATION OF CARGO RATE REGULATIONS

Although MARINA has met at least part of Tranche 3 conditionality by widening fork tariffs significantly, the policy condition of agricultural commodity reclassification had not yet been formally implemented as of August 3, 1993. Although the actual implementation shortfall is not strictly the result of MARINA inaction (CISO had not petitioned for a reclassification by August 1993), the situation may be interpreted as effective noncompliance. The monitoring team suggests, however, that SDP II conditionality might be interpreted in light of an alternative classification of more importance generally to the SDP II basic purpose of export development—an alternative that is easier for the Government of the Philippines to implement.

The Class C (basic) commodity category comprises grains, fruit, and vegetables. The Philippines produces corn at costs significantly above world market delivered costs, and the Philippines is not yet self-sufficient in either rice or corn. Thus, there are no short-term prospects for developing export markets for Philippine grains. Further, rice is not an important commodity in interisland trade (the major production area is also the major consumption area), and corn shipments are accommodated mainly by tramper vessels rather than by liners (at higher charges for tramper bulk transport than is permitted for containerized liner shipment). Thus, as the situation stands, commodity reclassification of grains would have no effect on export growth and might only shift some portions of grains from trampers to liners.

Fruits and vegetables, however, have good potential for both export and domestic trade growth. They are, moreover, accommodated only by liner shipping and air transport, and serious problems exist with the current manner in which they are being shipped. They are currently shipped in inappropriate conventional containers, passenger cabins, and other passenger areas; there is a dearth of the ventilated containers that would permit them to be moved without significant spoilage, spillage, or pilferage. Precedents exist for extracting a commodity from the Class C (basic) category and fully deregulating its cargo rates (e.g., the case of livestock), and there is precedent for fully deregulating the rates of all commodities transported in specialized capacity (e.g., the case of reefer boxes). In the case of fruits and vegetables, all that is required is the deregulation of ventilated container shipments. The LSRS included this recommendation in the draft MC 71-A. Thus, from the standpoint of SDP II basic objectives, finalization and issuance of MC 71-A, which contains ventilated container shipment rate deregulation, could be substituted for the full reclassification of all Class C (basic) commodities. Class C (basic) would still contain the commodities it does now, but the rates for that group would only apply if the commodities were shipped in standard containers or not containerized at all.

The foregoing suggestion does not imply that there is no longer an advantage to fully abolishing Class C (basic). First, it appears inequitable to liner shipping operators that they cannot charge rates for scheduled, containerized services as high as the unregulated, unscheduled, bulk tramper services for the same commodities. This inequity is exacerbated by the fact that many of the usually small grains shippers who use liner services leave their grains stored in operator containers for periods of 1 or 2 weeks at the ports of destination. This situation translates into an understandable reluctance on the part of liner operators to accommodate grains, especially in the "heavy" traffic direction. The MARINA action plan, to be transformed into a memorandum circular during 1993, calls for the establishment of freight-all-kinds (f.a.k.) container rates, which is another way of ending the adverse effects of the Class C (basic) category, even if the category is never abolished.

IMPROVED MANAGEMENT OF PUBLIC DEBT FINANCING

The monitoring team has concluded that the Government of the Philippines has discontinued plans for the small savers program, with no violation of conditions for the release of Tranche 3 of SDP II in this field, but that many of the underlying fiscal problems leading to plans for the SSI to begin with may still remain.

The small savers instrument as a means of improving efficiency in mobilizing financial resources was developed in an environment of high interest rates, large public sector interest payments, and crowding out of private sector borrowing by domestic public sector borrowing, which was large in relation to GDP. Although the first of these factors is currently ameliorated, the others are not. Interest payments as a proportion of the national budget and GDP remain large, and, in addition, projected domestic interest rates remain high. Because high interest rates have been a major factor in the underinvestment in the Philippine economy, the monitoring team recommends that the government pursue a strong program for structurally reducing domestic interest rates. A small savers instrument might form a useful component of such a program in the future, but many alternatives are currently available. In light of the rejection of the SSI by current government officials, the remaining alternatives may be a more positive means of addressing underlying fiscal problems.

The Government of the Philippines has embarked on a program of restructuring the domestic debt by offering medium-term floating rate treasury notes (FRTNs). This move is in the right direction, and it should be expanded and accelerated. Other reforms that could lead to structurally reduced interest rates are possible, including the phase-out of the gross receipts tax, the abolition of the agri-agra and small-and-medium-scale industry requirement, and the freer entry of foreign banks. At the same time, the Government of the Philippines should consider other means of increasing the term of domestic debt, as the SSI would have done. A recent study (Diokno and Lim, 1993) shows that increases in the public debt are reduced approximately 10 to 15 percent with a hypothetical increase in the maturity of domestic securities from 90 days to 360 days. Another reform measure that could lead to lower public sector interest rates through increased competition is to increase the volume of franchises for dealership for government securities while reducing the denominations of bids. These measures, singly and collectively, could help reduce interest rates paid by the Government of the Philippines, and consequently bring about higher private investment, while keeping the interest expense of public debt more manageable.

This monitoring report is not the place for analyzing such alternative means of public sector finance in detail, but resources for such analysis are available. The technical assistance funds allocated for this component of SDP II, and originally intended to be used for implementation of an SSI and related market studies, might now be used to assess alternative means of improving public sector financing. Such alternatives could form a component of future SDP conditionality or of general ongoing government reform.

Appendix A

SCOPE OF WORK

A. *Monitor progress and assess initial impact, if any, of GOP policy performance in terms of fulfilling the policy objectives, implementation actions and policy reform indicators under the third tranche of SDP II.*

The team of consultants shall assess progress in the implementation of the SDP II policy implementation matrix (PIM) under the third tranche. Implementation of the SDP II PIM means policy actions that tend towards fulfillment of the policy objectives, implementation actions and performance indicators of SDP II. The assessment shall include a brief discussion on the statistical data and information obtained and how these serve to indicate/determine the scope and depth of policy change implementation.

In the assessment of progress, the team, using a sample of firms/participants directly affected by these reform actions, shall evaluate the initial impact, *if any*, of these policy actions on market/industry structure and firm's behavior, marketing arrangements, volumes traded or output produced; actual or planned investments by market participants as a result of the policy change; increase/reduction in the number of market participants and resulting market and industry structure; implications of policy change on market and industry technology, etc. In this regard, the team is expected to consult private sector groups/industry associations on their views concerning the effectiveness of the policy change implemented in SDP II.

Below are suggestions to guide the team's assessment but need not be limited to them:

1. Highlight the main constraints and bottlenecks to policy change, classified according to external (beyond government agency's control) and internal (within the GOP system) factors, and discuss how they affected policy performance and progress in implementation of SDP II PIM.
2. Discuss the positive external and internal factors including key policy actions outside SDP II that facilitated the present level of progress and extent of implementation of each policy reform action supported by SDP II.
3. Compare the findings under tasks 1 and 2 above with those obtained for the second tranche policy monitoring and determine whether or not these findings under the present exercise are extensions/progressions of the policy implementation issues raised in the previous monitoring exercise.
4. Evaluate the GOP's policy monitoring or management information system with specific reference to the implementation of SDP II PIM and assess the system's capability, its strengths and weaknesses. The evaluation of the monitoring system shall take into account the improvements introduced since the second tranche and include appraisal of the quantity and quality of the technical staff doing the monitoring.
5. Assess the significance of the policy actions by the GOP for each policy-based SDP II tranche in the context of the overall ongoing stabilization and reform program of the GOP. This should be complemented by a brief review of the

macroeconomic situation and relevant sectoral policy environment during the implementation of SDP II.

Based on the assessment and the evidence cited, the team shall make a *firm determination* of the GOP's accomplishments for each mutually agreed-upon policy area/objective/action/indicator comprising the PIM under each policy-based tranche.

The team's assessment and determination of policy accomplishments under the third tranche shall make reference to the GOP's policy performance in the previous tranche.

If necessary, the team shall develop a decision criteria based on the factors explaining policy performance and the supporting information obtained for each policy change implementation supported by SDP II. The criteria shall have, at the minimum, the following characteristics:

1. Flexible enough to account for specific administrative and non-administrative problems and bottlenecks encountered under each policy change implementation;
2. A system of converting qualitative assessments of the scope, extent, seriousness of each policy change implementation into quantitative measures (e.g. objective grading system for satisfactory and nonsatisfactory performance) and that the resulting measures across policy sectors/actions of the SDP II PIM are comparable;
3. Clarity and acceptability of the norms/criteria that determine satisfactory and nonsatisfactory performance;

B. *Monitor and assess the pace and progress in the utilization of the technical support component as well as the sources of technical assistance implementation bottlenecks.*

The team shall review the implementation of the technical support component (TSC) of SDP II as of the third tranche and evaluate their significance in providing adequate technical support to the implementing government agencies. The monitoring and evaluation exercise for the TSC shall assess the implementation progress. The assessment shall contain reasons why or factors responsible for any major discrepancy between actual and planned implementation of the TSC since the second tranche.

Following specific activities may comprise the review and assessment of the implementation of the TSC but need not be confined to them:

1. Review the TSC implementation plan or its update and assess its effectiveness vis-a-vis the attainment of SDP II objectives;
2. Evaluate the progress of TSC implementation to date. Pinpoint specific bottlenecks in the process of TSC implementation and recommend ways to improve and hasten the pace of implementation for the remainder of the program taking into account GOP and USAID's organizational and management systems, external aspects/factors affecting or that may affect TSC implementation, in particular,and SDP II implementation, in general and any progress in TSC implementation since the second tranche;
3. Prepare a revised TSC implementation plan based on assessment of actual implementation and recommendations.

The team shall *provide an opinion* on whether or not the TSC under each policy-based tranche has contributed sufficiently to the present level and scope of policy implementation of the GOP under SDP II.

C. *Recommend measures to sustain the economic benefits from the policy performance (in terms of attainment of the policy objectives, implementation actions, and policy indicators) in the third tranche and improve utilization of the technical support component for the remainder of the program.*

Based on the tasks and findings of A and B, the team shall provide recommendations to sustain the economic benefits from implementation of policy change for each major policy reform area supported by SDP II. The recommendations shall cover as well further refinements and improvements of TSC implementation within the timetable of SDP II. Recommendations on how the TSC contribution to policy performance may be expanded at no cost and suggestions on raising the efficiency of the TSC implementation system will be appreciated.

Appendix B

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This appendix includes references of documents consulted for the monitoring reports for both Tranche 2 and Tranche 3 of SDP II. Those documents consulted for *only* Tranche 3 are indicated by an asterisk (*).

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Appendix C

PERSONS INTERVIEWED

This appendix includes names and titles of individuals interviewed for the monitoring reports for both Tranche 2 and Tranche 3 of SDP II. Those individuals consulted for *only* Tranche 3 are indicated by an asterisk (*).

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