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The Philippines: Living With a Foreign Debt Hangover [redacted]

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An Intelligence Assessment

~~Secret~~

EA 85-10013
February 1985

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The Philippines: Living With a Foreign Debt Hangover [redacted]

An Intelligence Assessment

This paper was prepared by [redacted]
[redacted] Office of East Asian Analysis.
Comments and queries are welcome and may be
directed to the Chief, Southeast Asia Division, OEA,
[redacted]

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The Philippines: Living With a Foreign Debt Hangover [redacted] 25X1

Key Judgments

Information available as of 18 January 1985 was used in this report.

The Philippines faces a prolonged struggle resuming even modest economic growth under the burden of its $25 billion foreign debt. The recovery will be especially sensitive to adverse developments in the international economy and domestic political turmoil—further complicating the Philippines' quest for social stability. [redacted] 25X1

Based on our econometric work that simulates the effects of Manila's debt rescheduling, we believe that the economic outlook through 1986 is bleak:
- National output will decline by 2 percent in 1985.
- The economy will grow no more than 2 percent in 1986 because of IMF-mandated restrictive monetary and fiscal policies designed to limit imports and ease inflationary pressures.
- Another round of debt rescheduling will be required in 1986, and again in 1987, to avoid a surge in principal repayments that would otherwise be due. [redacted] 25X1

A nascent economic recovery could be under way by the 1987 presidential election, if favorable economic conditions prevail abroad and the Philippines continues reforms pledged to its creditors in recent negotiations with the IMF. This assumes that President Marcos remains in power or that there is a fairly smooth transition to a new government with a minimum of domestic political upheaval, if he is incapacitated or dies during the next two years. [redacted] 25X1

On the other hand, if Manila breaks with its creditors it will postpone any chance of economic recovery until 1987. We believe noncompliance during 1985 alone, for example, would contract output by 7 percent. Backsliding on compliance, nonetheless, could result from turmoil accompanying a divisive presidential succession struggle, social discontent and unrest in reaction to austerity, or an acceleration of the Communist-backed insurgency and a widespread deterioration in domestic security. [redacted] 25X1

Even if all goes well at home and abroad, the debt crisis will continue to slow economic activity through 1990, and the political costs of austerity for the government will be substantial because of rising unemployment and higher taxes. With domestic stability and sound economic policies, favorable world economic conditions, and satisfactory levels of foreign financing, we expect annual GNP growth rates by 1988 of no better than 4 percent. Debt service will continue to be a burden and will reduce resources available for investment, consumption, and government spending. This would coincide with a period of rapid growth in the working-age population—3.3 percent annually—projected to be the highest in Asia and would ensure that the average Filipino experiences little improvement in living standards. [redacted] 25X1

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Contents

Anatomy of a Foreign Debt Crisis

Manila's foreign debt has increased tenfold since 1970, reaching $25 billion in 1984. A decadelong spending spree was made possible by an abundance of government guarantees to private Philippine borrowers linked to the Marcos administration and Manila's continued support for an overvalued peso—which artificially cheapened imports. In conjunction with a concentration of economic power in President Marcos's hands, borrowing has led to an explosive growth of state-controlled monopolies. [redacted] 25X1

25X1 [redacted] *Philippine investment became increasingly inefficient during the 1970s, and, on average, investment was 35 percent less productive than in similiar Asian countries.* [redacted] 25X1

The cost of the borrowing binge mounted rapidly by the early 1980s, aggravated by rising international interest rates, lower prices for Philippine export commodities, and the 1981-82 world recession. The Central Bank's growing dependence on expensive short-term borrowing for balance-of-payments support—such debt rose from 2 percent of GNP in 1970 to 17 percent in 1983—helped push debt service payments up to $2.9 billion in 1983. Debt service absorbed 35 percent of export earning and placed an unsustainable strain on the country's foreign exchange reserves, which dropped from an equivalent of 4.7 months of imports in 1979 to 1.4 months by 1983. Furthermore, inept management of those reserves left little more than $100 million on hand in mid-1983 to meet debt rollovers totaling $250 million a week. [redacted] 25X1

Manila's international credit rating, which began slipping in 1981 following a major financial crisis in the private sector, plummeted in early August 1983 amid rumors that Marcos was seriously ill and a succession struggle was under way. In the turbulent aftermath of Aquino's 21 August assassination, investor confidence evaporated. Manila devalued the peso by 22 percent in early October in a desperate but futile effort to obtain a new IMF standby loan and to stem a flight of peso capital into dollars. On 17 October 1983, out of money and credit, Manila declared a moratorium on principal repayments to foreign creditors, froze foreign exchange transactions, and asked the IMF and foreign bankers to organize debt rescheduling. Manila's arrears to foreign creditors exceeded $1.6 billion with another $1.6 billion in outstanding contingent liabilities for standby letters of credit and contract guarantees. [redacted] 25X1

[redacted] 25X1

The Philippines: Living With a Foreign Debt Hangover [redacted]

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Factors at Play

After a year of economic decline, political unrest, and intense bargaining, Manila has reached agreement with the IMF on an economic adjustment program and completed negotiations with its creditors on a plan to restructure much of the Philippines' $25 billion foreign debt (see table 1).[1] The agreements follow protracted negotiations in which Manila expected—unrealistically—to avoid an unpopular austerity program by persuading the IMF to ease its demands for onerous domestic economic policy adjustments. According to US Embassy reporting, the government was persuaded to accept the IMF's tough policy recommendations by the Central Bank's rapidly deteriorating foreign exchange reserves, a spate of headline-grabbing bank failures, and a US-initiated delay in approval of a $150 million loan by the World Bank. [redacted]

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The agreements come at a time when political tensions in Manila are high and speculation that President Marcos is seriously ill is rampant. The uncertainty surrounding Marcos's health has increased concern both within and outside the government that a presidential succession is much closer than has been previously believed. Of special concern is that Marcos's habit of keeping political institutions weak—including an ambiguous succession mechanism—ensures a rocky road to new leadership if he becomes incapacitated or dies.[2] [redacted]

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[redacted]

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Table 1
Composition of Manila's Foreign Debt: October 1983 Moratorium Levels [a]

Million US $

Total foreign debt	**24,281**
Medium- and long-term debt, by creditor	**15,027**
Banks and financial institutions	7,724
Supplier credits	1,496
Multilateral donors	3,780
World Bank	1,877
IMF	1,186
Others	717
Bilateral donors	1,351
United States	805
Others	546
Export credit agencies	535
Others	141
Short-term debt, by creditor	**9,254**
Banks and financial institutions	7,944
Supplier credits	1,230
Others	80

[a] Manila's foreign debt has changed very little since the October 1983 moratorium. As of 30 June 1984, Manila's total foreign debt stood at $24.8 billion, divided between $15.4 billion in medium- and long-term credits and $9.4 billion in short-term credits. Debt, as defined by the bank advisory committee and IMF, does not, however, include an estimated $3.2 billion in arrears or government liabilities on foreign construction contracts and long-term leases.

[redacted] 25X1

The jockeying among Marcos's inner circle that has accompanied his current health crisis has intensified widespread anxiety about the soundness of the succession process. [redacted] 25X1

[redacted] doubts over the prospects for a constitutional succession recently have dominated the agenda of senior officials in the military, the cabinet, and the ruling party. Differing legal interpretations of the succession mechanism, moreover, could, if Marcos dies, prompt debate within the National Assembly over whether the Speaker would share presidential authority with the Prime Minister. [redacted]

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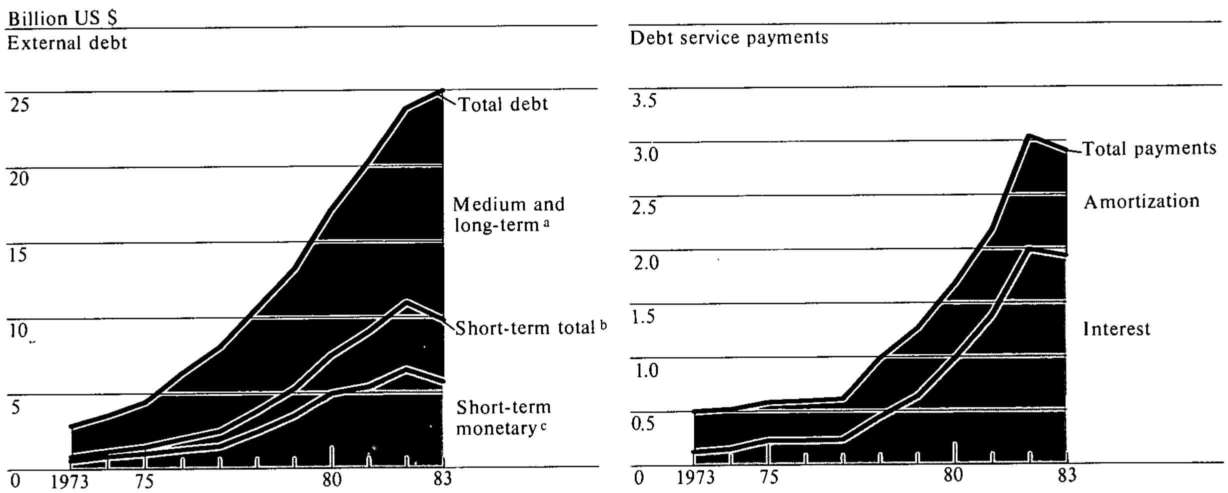
[2] The constitution calls for the Speaker of the National Assembly to act as caretaker president if Marcos dies or is incapacitated before his term expires in 1987. The National Assembly is to agree on special election rules within seven days, and the Speaker is then required to set an election within 60 days of Marcos's demise. Constitutional provisions prevent the Speaker from declaring martial law, dissolving the Assembly, and using the presidential decreemaking powers. [redacted]

[redacted]

Figure 1
The Philippines: External Debt and Debt Service, 1973-83



[a] Includes IMF loans.
[b] Includes short-term trade financing.
[c] Central bank and commercial bank short-term borrowing to finance international reserves.

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As a result of these concerns, the Philippines' economic outlook—even with the financial adjustment and debt restructuring agreements in place—is clouded by the possibility that presidential succession or incapacitation could alter the economic policies Manila has settled on with its creditors. We can envision two basic policymaking environments in the next few years. One environment—which may prevail either if Marcos remains in office or if his successor is drawn from the ruling elite or the moderate opposition—would reflect policy continuity, featuring reasonably good working relations between the government and its foreign creditors. We assume the Marcos government or its successor would decide it had no other option but to comply with most, if not all, of the creditors' austerity program in return for continued financial support. In this case, we believe the current financial rescue package for the Philippines would remain intact through 1986—the last year of the new program.

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The other environment—which would reflect a higher degree of domestic political turmoil—would see Manila breaking with its creditors and adopting more politically expedient economic policies. Such turmoil might result from a protracted succession struggle, for example, possibly including an extraconstitutional bid for power by someone like Imelda Marcos. It also could emerge from social discontent and unrest in reaction to financial austerity or the widespread deterioration in domestic security that might occur if the Communist-backed rural insurgency continues to gain strength. Because the course of political developments in the near term cannot be predicted with any precision, this assessment evaluates the economic growth paths that are likely to result from either set of circumstances—which will in turn bear heavily on the Philippines' long-term chances for internal stability.

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The Current Economic Picture

The Philippines' financial problems have already taken a heavy toll on the economy. Our analysis suggests that real GNP will record a decline for 1984 of 5.5 percent, compared with a 1.4-percent increase in 1983. Our analysis also indicates that public and private investment outlays have dropped by one-third,

Table 2
The Philippines: Balance of Payments

Million US $

	1979	1980	1981	1982	1983	1984 [a]
Current account	**−1,497**	**−1,904**	**−2,061**	**−3,200**	**−2,757**	**−1,542**
Merchandise trade	**−1,541**	**−1,939**	**−2,224**	**−2,646**	**−2,482**	**−487**
Exports	4,601	5,788	5,722	5,021	5,005	5,300
Of which:						
Coconut products	965	759	756	590	622	753
Sugar	238	474	609	440	321	315
Lumber	484	433	383	293	323	325
Copper	330	679	544	313	242	335
Nontraditional manufacturing	1,520	2,108	2,609	2,380	2,354	2,662
Imports	6,142	7,727	7,946	7,667	7,487	5,787
Of which:						
Oil	1,385	2,248	2,458	2,105	2,132	1,831
Services	**−311**	**−399**	**−309**	**−1,040**	**−747**	**−1,305**
Of which:						
Interest payments	626	975	1,374	1,911	1,929	2,380
Transfers	**355**	**434**	**472**	**486**	**472**	**250**
Capital account	**894**	**1,532**	**1,329**	**1,562**	**633**	**−744**
Direct investment (net)	20	−102	175	17	112	−20
Medium- and long-term loans (net)	1,151	1,032	1,332	1,548	1,392	−364
Short-term loans (net)	−558	196	−213	−56	−836	−500
Other	281	406	35	53	−35	140
Overall balance	**−603**	**−372**	**−732**	**−1,638**	**−2,124**	**−2,286**
Cumulative arrears on interest and principal payments—including debt payments covered by the moratorium					1,600	2,700
Indicators						
Current account deficit as percent of GNP	5.0	5.4	5.4	8.1	8.1	5.2
Annual percentage change						
Exports	34.4	25.8	−1.1	−12.2	−0.3	5.9
Imports	29.8	25.8	2.8	−3.5	−2.3	−22.7

[a] Estimates.

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while current government expenditures have fallen 14 percent. Furthermore, on the heels of successive devaluations and rapid money supply growth in early 1984, inflation is running at a 60-percent annual rate, after averaging no more than 15 percent annually over the last three years. [redacted] 25X1

The domestic impact of the financial crisis was slow in coming. [redacted] urban consumers maintained living standards by drawing on savings and relying on assistance from relatives. In the countryside, relatively stable farm incomes permitted many to continue consuming at traditional levels. Manufacturers and retailers, on the other hand, drew on stockpiled inventories and relied on black-market import financing in an attempt to sustain business operations. The initial economic shock was also moderated by an active black market in 25X1

Who Bears the Pain of Austerity?

The Philippines' recent economic decline and IMF-supported austerity measures are hitting urban centers disproportionately hard. Devaluations and the floating exchange rate system, tight monetary policies, and higher taxes and utility fees are undermining the profitability of import-intensive industries that cater to the domestic market, supplying beverages, tobacco products, textiles, appliances, drugs, and cement. These industries—dominated by business associates of President Marcos—have long been protected by discriminatory economic policies. [redacted] 25X1

25X1 [redacted] *over one-fourth of the firms in this sector—which employs 10 percent of the national labor force and produces 19 percent of GNP—face temporary or permanent closure.* [redacted] 25X1

Losses in the manufacturing sector will continue as imports become increasingly expensive, high interest rates further raise production costs, and domestic demand remains weak. [redacted] *this sector's real production—85 percent of which is sold in the domestic market—will decline 1 percent annually in 1985 and 1986.* [redacted] 25X1

Although exporters and farmers are not escaping unscathed from the austerity measures, they are the intended beneficiaries of the IMF's efforts at economic restructuring. Export manufacturers—and their urban work force—should eventually benefit from exchange rate and tariff policies favoring labor-intensive export production. Although we project that the restructuring effort could stimulate export growth rates of 12 percent beginning in 1987, we expect continued strikes and protests by urban workers opposing austerity measures until production accelerates. [redacted] 25X1

The economic adjustment program is having a mixed impact on agriculture, where production accounts for approximately one-fourth of national production and employs half the labor force. Although farmers will receive higher prices for their products because peso devaluations increase export revenues and price controls on major food crops will be eliminated, production costs will also climb as devaluations increase fertilizer prices—already up over 30 percent in 1984—and high interest rates drive up the cost of production loans. According to Philippine press reports, some rice farmers are switching to lower yielding varieties that require few manufactured inputs—a step that will reduce total rice production and contribute to Manila's estimated need to import about 300,000 metric tons of rice in 1985. [redacted] 25X1

On balance, we believe that the New Peoples' Army (NPA)—the military wing of the Communist Party of the Philippines—will benefit from the recession and debt crisis. For one thing, reduced military spending is restricting armed forces training programs; putting equipment modernization programs on hold; and adversely affecting overall operations, maintenance, combat readiness, and morale. When fighting the insurgents, government forces often have insufficient equipment, food, or transportation, according to US Embassy reporting. [redacted] 25X1 25X1 25X1

Although national-level linkages between the debt crisis and the insurgency can be inferred, cause and effect is much more difficult to establish at the local level. [redacted] *citizens support the NPA primarily because of specific, local grievances such as an abusive official or soldier, government inaction in providing a needed service such as medical assistance, or an injustice suffered at the hands of the local legal system.* [redacted] 25X1 25X1

The rural poor, moreover, are not a homogeneous group, but include such diverse groups as upland farmers, the landless, and fishermen, all of whom live at the edge of the money economy and depend on multiple-income sources for survival. Although the IMF-supported economic reforms are aimed at reversing economic policies discriminating against the rural producer, an effective development program for the rural poor cannot be undertaken amid the budget cutbacks and high interest rates sought by the IMF. Furthermore, development programs, flexible exchange rates, and higher farm-gate prices largely benefit the better off farmers who sell to the urban or export market. [redacted] 25X1 foreign currency, which initially prevented acute scarcities and pricing distortions; by the government's preelection spending, which stimulated consumption through June 1984; and by the debt moratorium, which deferred about $80 million in monthly debt principal repayments. [redacted] 25X1

25X1 [redacted] the state of the domestic economy is now far more serious. Consumers, for example, are finding it hard to make ends meet as real wages have declined by 25 percent. Unemployment has grown by 300,000 in Manila alone, [redacted] 25X1 and basic commodities are widely reported in short supply. [redacted] 25X1 even exporters, despite their priority access to foreign exchange, face difficulties financing production, obtaining necessary inputs, and remaining competitive with foreign producers. [redacted] 25X1

If the course of events in other financially troubled developing countries is repeated in the Philippines, the domestic slowdown will produce external financial benefits. The economy's trade deficit already has registered its first improvement since 1977. We calculate that the current account deficit will shrink by $1.2 billion for 1984—largely because of a drastic 23-percent decline in imports. Although the nearly 50-percent depreciation of the peso since October 1983 has not immediately aided most exporters—who must cope with increasing wage costs and are hampered by the high-import content of their production—the depreciation promises to boost exporters' profits and encourage export-oriented production in the years ahead. [redacted] 25X1

The Rescue: A Foundation for Recovery

Manila's multiyear rescue package—the key to the country's economic future—includes arrangements for financing the balance of payments and stipulations on economic policy designed to cure the country's financial ills over the longer term [redacted] The basic ingredients are a $615 million IMF standby loan, an $8.5 billion financing package from commercial creditors—consisting of new loans, rescheduled debt payments, and revolving trade credits—and $3 billion in new loans and rescheduled debt payments from official creditors. The rescue package is based on the IMF's calculations that Manila needs $3.9 billion in financing to meet its foreign exchange requirements through 1985. [redacted] 25X1

The economic policy concessions required of Manila by the IMF are considerable. As a precondition to IMF approval of the adjustment program, in mid-October Manila implemented a unified floating exchange rate system—a step designed to stimulate exports by correcting the overvalued peso. The adjustment program also requires that Manila cut the public-sector budget deficit by increasing revenues with new sales and excise taxes, repealing tax exemptions enjoyed by public entities and various private-sector organizations, and raising utility rates. [redacted] 25X1

In addition, the government has promised to reduce investment expenditures, constrain growth of the money supply, limit wage increases, freeze public-sector hiring, virtually eliminate subsidies to public corporations and public financial institutions, and improve the efficiency of public-sector financial institutions. Futhermore, the government is to enact agricultural marketing and pricing reforms designed to increase supplies for domestic consumption and export. Special emphasis will be given to dismantling the government-sanctioned sugar and coconut monopolies. [redacted] 25X1

The commercial bank financing agreement makes an important contribution to Manila's short-term quest for financial stability by postponing a large share of the country's principal repayments—$2.1 billion due in 1984 and 1985—thus providing relief equivalent to about 20 percent of export earnings. Furthermore, the financing package permits foreign banks to extend rescheduling through 1986 at their option. This would postpone another $1.2 billion in amortization payments—provided that the IMF approves a new adjustment program extending at least through December 1986. [redacted] 25X1

Alternative Economic Futures

With debt restructuring and the rescue package in mind, and with the aid of an econometric model, we have analyzed the probable courses for the economy during the next several years. 25X1 The actual path taken will reflect a combination of external factors that we cannot forecast with any precision, including changes in world trade, international interest rates, and oil prices [redacted] If, for example, GNP growth 25X1

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in the Philippines' major trading partners falls 2 percentage points below our baseline scenario, we project that, by 1988, Philippine per capita GNP would be 10 percent below our baseline level. 25X1

Reflecting our expectations about alternate policymaking environments in Manila in the years ahead, we have devised two basic simulations. In general, we believe that Manila will be faced with choosing between the policy prescriptions of its creditors—chiefly the IMF—or charting a course that seems more politically expedient. Our baseline forecast, thus, is one of policy continuity. Our alternative forecast simulates a break between Manila and the IMF. 25X1

In either case, our simulations show that the economy will continue contracting through 1985 from the cumulative impact of declining imports, high interest rates, and tax increases combined with reductions in government spending and declining investment. Nevertheless, we believe that the $10 billion financial rescue package of new loans and rescheduled debt, along with fundamental economic reforms, can form the basis of an economic recovery beginning in late 1986. 25X1

Our Baseline Forecast. However essential it may be to the economy's long-term well-being, the IMF program does not signal an immediate renewal of the 7-percent average annual growth rates the Philippines enjoyed in the 1970s. In fact, austere fiscal policies will hold down domestic demand while tight monetary policies, with interest rates in excess of 40 percent and slow money supply growth, should significantly restrict domestic bank lending in 1985. 25X1

With the IMF-supported austerity program in place and favorable external economic conditions, we believe real GNP will decline by approximately 2 percent in 1985 before growing by about 2 percent in 1986. A population growth rate of more than 2.5 percent annually, however, will result in per capita income in 1986 below the 1983 level. 25X1

Manila's annual requirements for new medium- and long-term foreign lending through 1988 will be substantial, $1.4 billion—an amount we believe Manila can secure, if only barely, from its official and commercial creditors. Such financing, nevertheless, will not be sufficient to rebuild foreign exchange reserves from their current dangerously low levels.

Moreover, Manila will need to extend its debt rescheduling agreements into 1986 and 1987 to deal with amortization payments on commercial and official debt, which will total nearly $2 billion annually.

The Downside Risk. Even if the Philippines' current political problems ease, we believe that the costs of austerity through 1986 will continue to be heavy. The Philippines' strained relations with its creditors and its recent record of tough negotiations with the IMF suggest that Manila could be tempted into a confrontation with the IMF over economic policy sometime during this period. Manila, for example, promises to limit nominal wage increases this year to no more than the projected inflation rate of 25 percent and to freeze public-sector hirings. Furthermore, additional taxes and higher utility fees are planned. Continued domestic unrest could prompt the government to grant tax, wage, or price relief—moves that might jeopardize the hard-won financial rescue package and condemn the economy to further recession. Tax and agricultural reforms, moreover, will require that Marcos withdraw economic privileges from his closest associates—men like Eduardo Cojuangco, who has been one of Marcos's strongest supporters for more than a decade.

Quarterly IMF reviews—which monitor Manila's compliance with quantitative economic performance targets and the policy guidelines of the program—are currently the basis for continuing with loan disbursements. The Philippines, however, has already failed to meet the first performance target set by the IMF—the 31 December money supply level. This development temporarily puts Manila out of compliance with the Fund's program. As a result, the IMF is postponing loan disbursements scheduled for March, although disbursements could resume in May if the government brings the money supply down to target levels. Among other things, Manila's failure to meet the money supply targets may hold up disbursement of new commercial bank financing, which depends on continued compliance with the IMF program.

If Manila remains out of compliance with IMF targets and loan disbursements cease—as they did in 1983—the Philippines would need to balance its external accounts rapidly. The small amounts of new external financing and precariously low foreign exchange reserves—which in October 1984 plunged to a historically low $470 million—would be insufficient to support the $1 billion current account deficit projected for 1985. To trim the external deficit, we would anticipate additional budget cuts, higher interest rates, quantitative restrictions on imports, and a request to creditors for another moratorium on external debt payments.

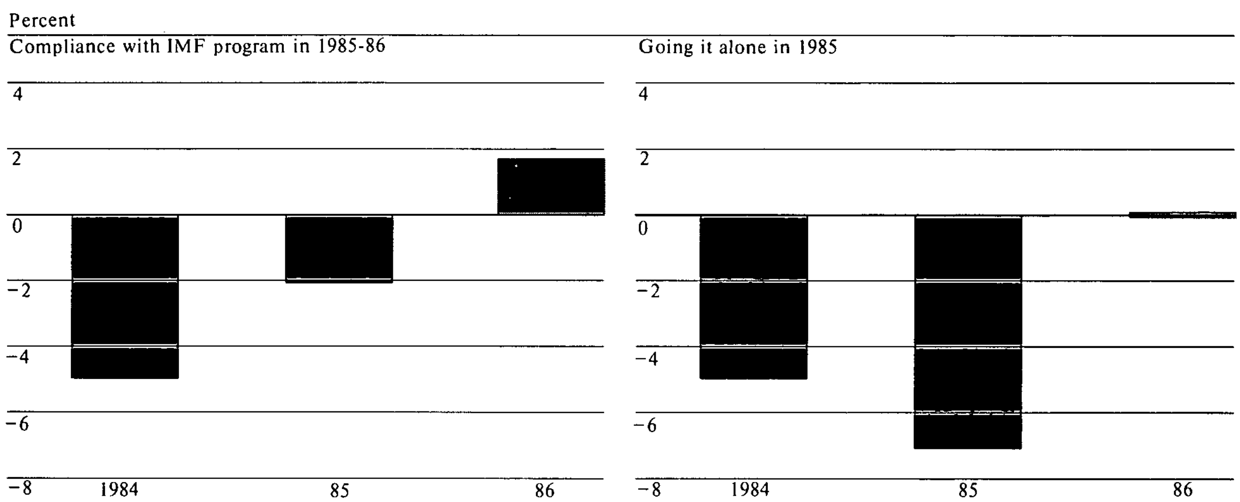
Such a course—however politically tempting initially—is not a realistic long-run option for any Philippine government, in our judgment. As a result of austerity without the financial cushion of the rescue package, for example, we believe real GNP would fall by over 7 percent in 1985—compared with the 2-percent decline under the IMF-supported program (see figure 2). Belt-tightening would cut investment in 1985 by 30 percent from 1984's already low levels, trim government consumption one-quarter, and squeeze another 1 percent out of private consumption. Furthermore, despite measures to restrict domestic demand, Manila would risk driving inflation to 45 percent in 1985—as domestic spending concentrates on the few imported and domestic goods available for purchase.

For their part, commercial and official creditors would probably not remain passive during another debt moratorium. Banks probably would suspend loan disbursements and selectively refuse to renew trade credits. Furthermore, if Manila fails to keep current on payments to official creditors, some bilateral donors will be required to suspend further assistance. For this reason, we believe that the passage of time strongly favors a continued—if frequently tense—relationship between Manila and its creditors.

Looking to 1990

Our analysis indicates that in the longer term the economy would benefit from a bout of belt-tightening and economic reforms, leading—in the absence of

Figure 2
The Philippines: Forecasts of Real GNP Growth, 1984-86



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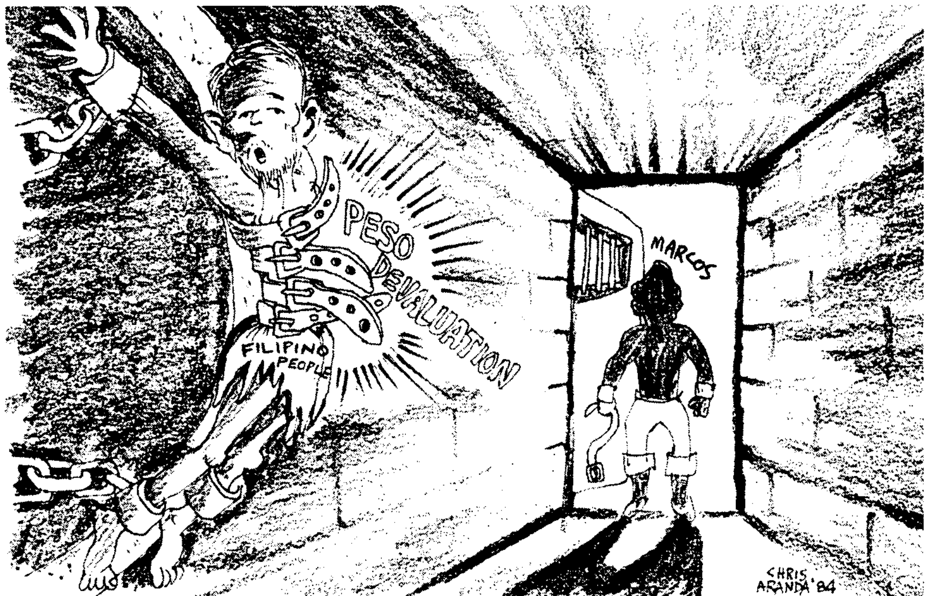
radical shifts in economic policy—to moderate growth by the end of the decade. A floating peso and restrained domestic demand—which curtails imports and rewards exporters—would lead to impressive reductions in the trade balance. Overall, we believe that fundamental economic reforms—changing the nature of the agricultural monopolies, the pattern of rural development, and the tax structure—would enable the economy to emulate eventually some of its more successful Asian neighbors such as Thailand and Malaysia. These reforms are considerably more likely now that they have IMF and World Bank sponsorship. 25X1

Even if all goes well, Manila's foreign debt burden will continue to constrain economic growth through 1990, depressing living standards and further aggravating already high unemployment levels. With sound economic policies, favorable conditions prevailing in the world economy, and some measure of business confidence restored, by the late 1980s our simulations suggest that annual GNP growth rates will not exceed 4 percent (see figure 3). 25X1

Imports will be constrained as the Philippines becomes a net exporter of foreign exchange because its interest payments on foreign debt—which will average more than $3 billion annually—will exceed net capital inflows by about $2 billion. Limited imports, combined with little domestic investment and high interest rates, preclude rapid growth in the key agricultural and manufacturing sectors—which together account for nearly half of national output and employ almost two-thirds of the labor force. Furthermore, debt service payments will bunch again in 1989—jumping $500 million over 1988 levels—when rescheduled loans begin falling due. Without additional debt rescheduling agreements, debt service payments will continue absorbing nearly 40 percent of export earnings by 1990, reducing foreign exchange available for productive investments, private consumption, or government spending. 25X1



OH, NO... NOT AGAIN!!

Philippine News ©

With the labor force projected to be growing at a 3.3-percent annual rate through the decade, and only modest amounts of new investments being made, the economic recovery will not create enough jobs to absorb the 800,000 new workers entering the labor force each year, aggravating unrest among the marginally employed.[4] We cannot predict what level of urban unemployment would produce social unrest, and several social institutions in the Philippines, such as the extended family system, act as "shock absorbers" in a deteriorating labor market. At the very least, however, these institutions will undergo added strains for the near future, and we believe the risk of social unrest will increase as a result. For these reasons, we believe that the Philippines' road back to financial stability will be long, difficult, and easily derailed by both domestic and external factors.

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[4] The government can expect virtually no relief from population pressures before the year 2000, and providing jobs for a rapidly growing labor force will be Manila's most difficult economic challenge between now and the turn of the century.

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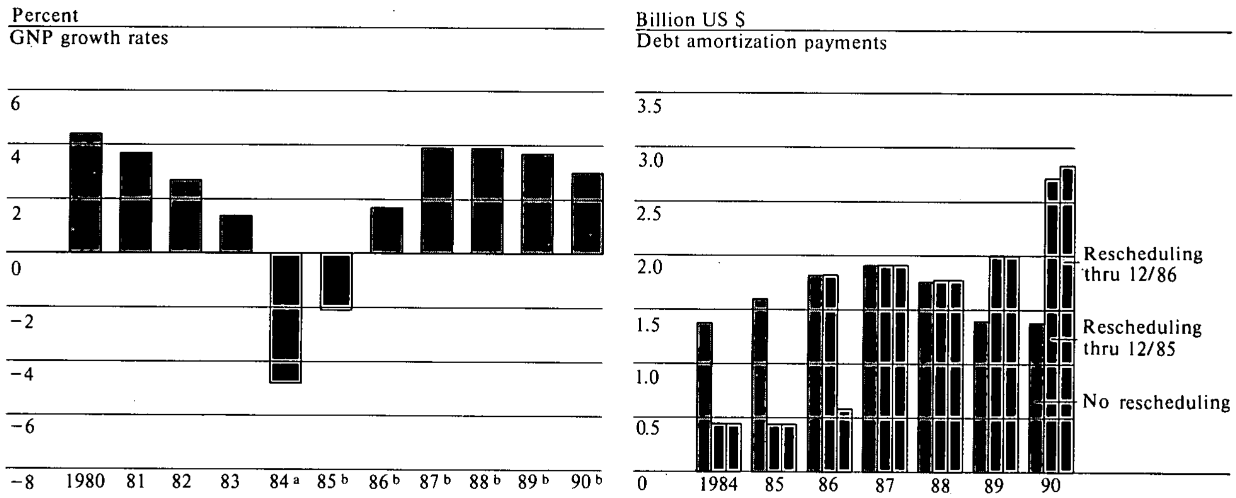
Figure 3
The Philippines: Projected GNP Growth and Debt Payments Under Favorable Conditions, Through 1990



[a] Preliminary.
[b] Optimistic scenario projections.

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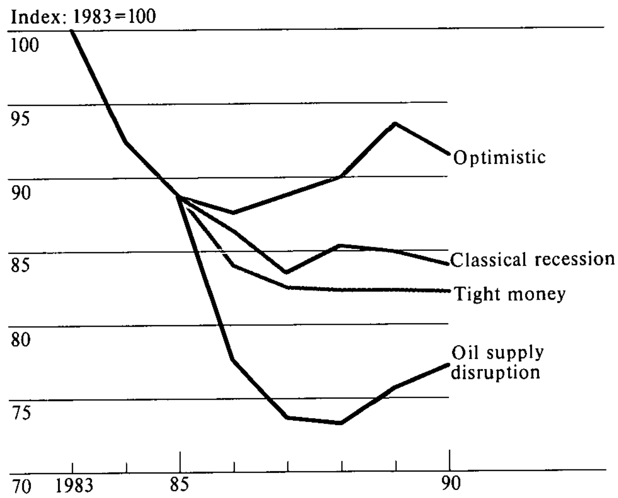
Figure 4
The Philippines: Index of Projected Per Capita Real GNP, 1983-90



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Appendix B

IMF Programs in the Philippines

The Philippines' relative economic stability through 1980 was attributed by many analysts to a long working relationship between Manila's technocrats and the IMF. Manila, indeed, has entered short-term IMF adjustment programs almost continuously since 1967. Until 1978, however, the programs were relatively small—less than $50 million—and were used by Manila largely to secure the Fund's "Good Housekeeping seal," an approval which paved the way for large-scale borrowings in the international credit markets. [redacted] 25X1

The programs were largely successful in meeting their immediate objectives and minimizing the disruptive impact of the first and second oil-price shocks in 1973-74 and in 1979-80. The IMF's balance-of-payments objectives were not achieved through fundamental structural adjustments to tariffs or taxes, however—even though the Fund recommended such reforms—but by Manila's heavy borrowing from international creditors. In fact, we believe Manila's current financial crisis illustrates the failure of short-term adjustment efforts that are implemented in the absence of a longer term program of economic policy reforms. In the Philippines, such longer term reforms began only in 1980 with the World Bank's first structural adjustment program. [redacted] 25X1

A recent University of the Philippines study reportedly concludes that, although the IMF had been aware of Manila's circumventions of its programs, the Fund failed to grasp their impact on the economy's plunge into a debt crisis. The study also criticizes the Fund for not slowing the Philippines' accumulation of short-term credit. The Fund's successes and failures in the Philippines since 1970 are detailed in the following paragraphs. [redacted] 25X1

The 1970-75 Period

The IMF approved six standby loans for Manila, each designed to maintain economic growth, limit the balance-of-payments deficit, and trim inflation. Overall, economic performance was erratic during this period. Implementation was delayed by severe flooding in 1971 and the oil-price increase of 1973. An acceleration of short-term capital inflows, however, permitted Manila to meet the IMF's balance-of-payments targets. [redacted] 25X1

The 1976-78 Period

Manila was under a three-year extended fund program aimed at achieving balanced and accelerated economic growth and a workable balance-of-payments deficit and raising tax revenues to 16 percent of GNP. The extended program came close to meeting its annual targets. This "success," however, was obtained largely because rising export prices led to better-than-expected terms of trade. Structural adjustments in the tax system were not achieved and tax revenue reached only 14 percent of GNP. [redacted] 25X1

The 1979 Program

The IMF approved a one-year standby to help Manila adjust to the second oil-price shock, consolidate gains made under the extended fund program, and make headway in reforming the tax structure. Program targets were achieved, but fundamental tax reforms were not put into place. [redacted] 25X1

The 1980-81 Period

The IMF developed a two-year standby program that continued the basic objectives of the 1976-78 program. Additionally, the program sought to accelerate investments in the energy and industrial sectors. Overall, Manila turned in a poor performance meeting program targets. Following a 1981 domestic financial crisis and worse-than-expected terms of trade, the IMF relaxed program targets to protect domestic incomes. The IMF learned in late 1983 that Manila had been manipulating its published international reserve and monetary data since 1981, thereby hiding the extent of the country's economic deterioration.[5]

[redacted] 25X1

[redacted] 25X1

The 1982-83 Period

Despite lengthy and intense negotiations, Manila and the IMF were unable to develop a program for 1982. The two parties disagreed on targets for the government's budget deficit, the balance-of-payments deficit, and external debt. [redacted]

25X1

In February 1983 the IMF approved a one-year, $350 million standby loan on the condition that Manila would trim the government's budget deficit, significantly increase exports, restrain money growth, and limit new foreign borrowings. The Fund expected these actions to pave the way for economic growth rates of 4 percent annually in 1984 and 1985. The program and loan disbursements were suspended after the June 1983 performance review concluded that Manila was not in compliance with many of the program's basic targets. [redacted]

25X1