Chapter 4

Renewed Economic Expansion and New Balance-of-Payments Problems, 1966–71

THE FIRST MARCOS ADMINISTRATION, 1966–69

Expansionary Monetary and Fiscal Policies, 1966 to Mid-1967.

Immediately upon its assumption of power in 1966, the Marcos administration initiated vigorous efforts to accelerate development in both the agricultural and industrial sectors. In the first month of the year, the monetary authorities pursued a policy which they described as one "of massive credit relaxation." [1] The basic rediscount rate of 6 per cent was lowered to 4¾ per cent, rediscount ceilings on commercial banks were raised, reserve requirements against savings and time deposits were reduced, and the reserve requirement on special time deposits was cut from 100 per cent to 50 per cent.

Further steps to ease the credit situation followed in later months. The reserve requirement on special time deposits was reduced to 25 per cent in February, and finally in March the special time-deposit requirement for all import letters of credit and the reserve requirement against these deposits were eliminated. With this policy step the exchange-control system became completely liberalized. (However, Phase V of the Bhagwati-Krueger schema is dated as beginning in November 1965, when a unified exchange rate was established.) Rediscount ceilings continued to be increased with the result that by July 1966 the amount of Central Bank credit available to the commercial banks was three times as large as that available in December 1965. Special advances from the Central Bank outside of the rediscount ceilings were also made available to certain banks. In June, the old selective credit system establishing credit ceilings for different types of loans was abolished and replaced by a more modest scheme limiting the types of credit instruments eligible for rediscounting at the Central Bank.

The monetary authorities continued their easy money policy through the first half of 1967. For example, in support of the government's efforts to expand rice production, the Central Bank in early 1967 issued circulars permitting commercial banks to rediscount a larger proportion of the commercial paper issued by the Rice and Corn Administration (RCA) and authorizing the Philippine National Bank to rediscount promissory notes of the RCA with the Central Bank at the 3 per cent preferred rate. The regulations covering foreign borrowing through standby letters of credit for the purpose of generating pesos were also eased. Still another expansionary policy was the reduction of the maximum interest rate paid on time deposits by commercial and savings banks from 6½ per cent to 6 per cent. The announced purpose of this move was to enable these banks to reduce their prime rates on loans for production purposes and for projects included in the government's development program.

Another important financial operation aimed at restoring full utilization of the economy's productive capacity was the so-called rehabilitation program of the Development Bank of the Philippines (DBP). This refinancing program for distressed firms consisted of three parts, namely: (1) refinancing through such conventional methods as loan extensions, deferments, and revision of loan terms; (2) conversion of DBP industrial loan accounts into preferred stock of the assisted firms which later could be converted into common stock; (3) foreign-exchange financing of imports of machinery and raw materials through credit lines and guarantees arranged by DBP with banking institutions and government export-import agencies abroad. Between April 1966, when the program started, and the end of the year, about fifteen hundred loan accounts amounting to P252 million were refinanced through conventional methods, whereas a total of P62 million was invested by the bank in the preferred stock of some eight firms. In 1967, refinancing through conventional methods totaled P265 million and through the securities scheme P735 million. To implement the refinancing program, the bank issued bonds that could, if the holder wished, later be exchanged for any of the industrial preferred shares available in the bank's portfolio. By the end of 1967, about P200 million worth of such bonds had been issued.

In addition to providing easier credit conditions, the new administration embarked upon a large-scale program of economic development which emphasized rural infrastructure investments such as roads, irrigation projects, schools, telecommunications, etc. The administration apparently chose to focus upon rural development on the grounds that it was the rural sector which was constraining efforts to restore the high growth rates of the 1950s.

In particular, the most influential economic advisers of that time believed that the inflation of about 25 per cent in food prices between 1962 and 1965 was the major factor in preventing the earlier decontrol and currency depreciation efforts from restoring high growth rates. Expanding the rural growth rate would supposedly provide larger amounts of foreign exchange for imports of capital goods and raw materials by increasing traditional exports and reducing food imports, would increase the supplies of wage goods for the industrial sector, and would increase the market for domestic manufactures. The magnitude and composition of the national government's capital expenditures program from 1959 through 1971 are indicated in Table 4-1. As is shown in the table, the volume of capital outlays rose significantly in the 1966–69 period. However, distribution of expenditures between social and economic development remained essentially unchanged.

In order to finance capital formation activities of the national and local governments as well as those of such government corporations as the Development Bank of the Philippines, and also provide funds for expanded current expenditures on developmental services, it was necessary for the government to engage in extensive borrowing both internally and externally (see Table 4-2). The internal debt increased from P3.1 billion at the end of 1965, or 14.7 per cent of GNP, to P5.8 billion by the end of 1969, or 18.4 per cent of GNP; and the external public debt rose from $491 million to $828 million between these years. The Central Bank, the commercial banks, and various government entities ended up as the main holders of outstanding internal debt. Specifically, about P2.4 million of the P2.7 million total increase in internal debt was absorbed by these institutions.

Credit Tightening and the Reintroduction of Exchange Controls, Mid-1967 Through 1968.

The significant expansion of domestic credit and the rise in government investment expenditures brought about an upward movement in prices as well as a deterioration in the balance of trade. Wholesale prices rose 6.6 per cent between 1965 and 1966 and 7.4 per cent between 1966 and 1967. However, more important to policymakers than the price rise was the worsening of the country's trade balance. From a trade account surplus of $24 million in 1965 and a deficit of $9 million in 1966, the merchandise trade deficit rose to $224 million in 1967. To help finance these additional net imports, the country drew on its gold tranche of $27.5 million at the International Monetary Fund. Other important policies that were undertaken by the Central Bank in the period from mid-1967 through 1968 are summarized in Table 4-3.

Starting in mid-1967, the Central Bank began to reverse its easy credit policies. In June of that year, the bank acted to raise the reserve requirements

TABLE 4-1

Average Annual Capital Outlays[a] by the National Government and Ratio of Total Government Expenditures to GNP, Fiscal Years, 1959–71

(values in millions of pesos)

	1959–61		1962–65		1966–69		1970–71	
	Value	Percentage Distribution	Value	Percentage Distribution	Value	Percentage Distribution	Value	Percentage Distribution
Economic development	189.5	76.4	254.6	85.3	370.8	84.9	463.1	82.5
Agriculture and natural resources	49.3	20.6	83.2	27.9	79.4	18.2	70.6	12.6
Transport and communications	102.5	42.0	147.2	49.3	215.2	49.3	255.7	45.6
Commerce and industry	15.9	5.0	7.7	2.6	4.4	1.01	37.2	6.6
Other	21.8	8.8	16.5	5.5	71.8	16.4	99.6	17.7
Social development	45.5	18.1	33.1	11.1	45.6	10.4	69.1	12.3
Education	26.0	10.7	15.2	5.1	36.8	8.4	50.1	8.9
Public health and medical care	17.8	6.9	13.1	4.4	8.2	1.9	14.5	2.6
Labor and welfare	1.6	0.5	4.8	1.6	0.6	0.1	4.4	0.8
National defense	2.7	1.2	2.1	0.7	6.0	1.4	11.4	2.0
General government	9.9	4.2	8.7	2.9	14.2	3.3	17.6	3.1
Total	247.5	100.0	298.5	100.0	436.6	100.0	561.2	100.0
Ratio: total government expenditures to GNP[b]	10.50%		11.16%		11.12%		12.48%	

SOURCE: Philippine Budget Commission.

a. Data on capital outlays are for fiscal years.

b. Data on total government expenditures and GNP are for calendar years.

TABLE 4-2

Internal and External Debt of the Government and Monetary Institutions, 1949–71

End-of-year Averages	Internal Debt (millions of pesos)				External Debt (millions of dollars)		
	Total	National Govt.	Local Govt.	Govt. Corp.	Total	Govt.	Monetary Institutions
1949	466	317	66	83	117	117	—
1950–53	666	503	65	98	111	111	—
1954–57	1,266	915	40	311	89	89	—
1958–61	2,136	1,465	32	639	175	139	35
1962–65	2,904	1,831	35	1,038	324	219	105
1966–69	4,522	2,686	102	1,734	689	359	330
1970–71	6,635	3,966	106	2,534	1,058	556	502

SOURCE: Central Bank of the Philippines, *Statistical Bulletin*, December, 1970, pp. 251–252 and 256; and Central Bank, *Annual Report*, 1971, pp. 26 and 29.

TABLE 4-3

Major Trade, Payments, and Related Economic Policies, 1967–68

June 1967	Central Bank initiated stage-by-stage increase in reserve requirements from 12 to 16 per cent; raised rediscount rate from 4¾ to 6 per cent, and required commercial banks to maintain 1-to-1 ratio between actual foreign-exchange assets and foreign-exchange liabilities.
	Reimposition of cash margin deposits when letters of credit are opened.
Feb. 1968	Further increase in rediscount rate to 7.5 per cent.
March 1968	Imposition of absolute limit on foreign-exchange liabilities of commercial banks.
June 1968	Replacement of cash margin requirement with special time-deposit requirement against letters of credit: the less essential the imported goods, the higher the percentage requirement.
Oct. 1968	Imposition on commercial banks of ceilings on domestic loans and on foreign-currency letters of credit.
	Announcement of stage-by-stage reduction in time-deposit requirement against letters of credit for essential producer goods. Imposition of ceilings on credit for import financing and on domestic loan portfolios.

for commercial banks gradually from 12 per cent to 16 per cent, increased the basic rediscount rate from 4¾ per cent to 6 per cent, stipulated that commercial banks must maintain a 1-to-1 ratio between actual foreign-exchange assets and foreign-exchange liabilities, and issued a circular under which all imports over $100 were to be covered by letters of credit. Furthermore, the monetary authorities were successful, through so-called moral suasion, in obtaining an agreement among the commercial banks to impose cash margin deposits on the opening of letters of credit. The schedule was as follows:

Essential producer and consumer goods	25%
Semiessential producer goods	50
Semiessential consumer and nonessential producer goods	75
Luxury items and nonessential consumer goods and others	150

The margin deposits were subject to a 100 per cent reserve, 50 per cent of which could be in the form of government securities. The deposits were to be held by the banks until the corresponding import bills were liquidated. Together with other controls imposed during the 1967–70 period over the free use of foreign exchange, this action marked a return of the Philippines to Phase I of the Bhagwati-Krueger schema, namely, the introduction and gradual tightening of exchange controls. However, it must be emphasized that these controls were much less stringent than those adopted in the early 1950s. Later in 1967, exemptions from the margin requirement were made for certain raw materials imported by selected local industries, for some 57 commodities in the essential-consumer-goods category, and for 4 items in the essential-producer-goods category. Furthermore, the financing of imports of these items was permitted through open-account arrangements.

Two later actions involved accelerating the increase in the reserve requirement against demand deposits so that it reached 16 per cent by November 30, 1967, and restricting the sale of foreign exchange for travel to $50 per person per day with a yearly maximum of $1,500 per person.

Additional steps to limit credit and reduce the drain on foreign exchange continued to be adopted in 1968. In February the basic rediscount rate was raised from 6 per cent to 7½ per cent, and the preferential rate for loans on rice and corn, from 3 per cent to 4 per cent. In the international area, the Central Bank, in March 1968, lifted the requirement that commercial banks maintain a full cover of their foreign-exchange liabilities, but introduced in its place a requirement that, for any one bank, foreign-exchange liabilities not exceed their June 27, 1967, level or $1.5 million, whichever was higher. However, in September, this was raised to $2.5 million per bank. To increase the time during which the cash margin must be held, the Central Bank also stipulated, in March, that letters of credit must be opened on or before the actual date of shipment.

In June 1968 the cash margin requirement was replaced by a special time-deposit requirement against letters of credit, which were to be held for 120 days. The percentages were also increased to the following levels:

Essential producer and consumer goods	50%
Semiessential producer goods	75
Nonessential producer and semiessential consumer goods	100
Nonessential consumer goods and unclassified items	175

In October the time-deposit requirement for essential producer goods was modified: it was immediately reduced to 40 per cent and then was reduced gradually to a level of 25 per cent by mid-December. A few additional changes in the other groups of items were also made. As a result, by mid-December the rates were as follows:[2]

Essential producer goods	25%
Essential consumer goods	50
Semiessential producer goods	75
Nonessential producer and semiessential consumer goods	100
Semiunclassified producer goods	125
Nonessential consumer and semiunclassified consumer goods	150
Unclassified producer and unclassified consumer goods	175

In order to prevent the October reduction of the special time deposit for essential producer goods from aggravating the deficit pressures on the balance of payments, the Central Bank simultaneously imposed ceilings on credits for import financing as well as on domestic loan portfolios. As of mid-November 1968, total outstanding foreign-currency letters of credits and total credits for import financing were limited to their mid-October levels. However, imports for dollar-earning industries or infrastructure projects, including the government's development program, were exempted from the ceilings. The ceiling set on banks' domestic loan portfolios was 105 per cent of the level of these portfolios as of October 12, 1968, and was reduced to 102 per cent of that level on December 31. Export credits as well as loans for rice and corn production or distribution were exempted from this requirement.

Despite tightened credit policies and the introduction of controls over foreign-exchange dealings, domestic loans and investments by the banking system expanded 21 per cent in 1967 and another 11 per cent in 1968. The time-deposit requirement was not as effective as was hoped for, due to foreign financing of the special time deposit.[3] The trade account deficit rose from its 1967 level of $224 million to $274 million in 1968. Again the Central Bank resorted to assistance from the IMF and drew on its first and second credit tranche totaling $55 million.

One encouraging factor in the country's growth efforts in 1968 was the relative stability of prices. Despite the 11 per cent increase in domestic credits, wholesale prices rose only 4.8 per cent, and consumer prices, 0.7 per cent. The major reason for this reasonably satisfactory price performance was the breakthrough in rice production starting in the latter part of 1967. The successful use of high-yielding varieties of rice as well as the expansion of irrigation facilities not only increased yields per acre by 4.4 per cent between 1967 and 1968 but also led to a 6.7 per cent increase in the harvest area for rice. Between 1960 and 1966 total rice production had risen only 9 per cent, whereas between 1966 and 1968 it increased 18 per cent.

Balance-of-Payments Difficulties in 1969.

The balance-of-payments situation continued to worsen as the government pursued deficit-spending activities, until it reached crisis proportions near the end of 1969. The major actions of the Central Bank in that year are indicated in Table 4-4. During the first few months of the year, controls over

TABLE 4-4

Major Trade, Payments, and Related Economic Policies, 1969

April 1969	Reduction in length of period that special time deposits must be held, and exclusion of domestic loans to certain export industries from previously instituted credit ceilings.
	Lifting of ceiling on foreign-exchange liabilities of commercial banks.
	Increase in rediscount rate from 7.5 to 8.0 per cent.
June 1969	Introduction of 2 per cent levy on all Central Bank loans and advances. Loans to government and high-priority export industries were excluded from this charge.
	Opening of import letters of credit permitted only for essential consumer and producer goods, semiessential producer goods, and nonessential producer goods. Ceiling for permitted letters of credit in these categories also reduced.
Nov. 1969	Further reduction in ceiling on import letters of credit.

trade were actually eased somewhat, though the trade deficit for the first two quarters was running at an annual rate of $270 million. In April, for example, the Central Bank reduced the period during which banks must hold the special time deposits required for import letters of credit from 120 days to 90 days for the following groups of commodities: essential producer goods; essential consumer goods; semiessential producer goods; semiessential consumer goods;

nonessential producer goods; and semiunclassified producer goods. For the four remaining categories—nonessential consumer goods, semiunclassified consumer goods, unclassified producer goods, and unclassified consumer goods—the time requirement remained at 120 days. The bank also issued a memorandum, in April, excluding export-oriented industries from the ceilings on domestic loans.[4] Imports of machinery and equipment for use in export-oriented activities were also exempted from the special time-deposit requirement.[5]

Additional liberalizing measures were taken in April 1969. Most important was the lifting of the ceiling on foreign-exchange liabilities of commercial banks. Another was the revoking of a November 1968 circular of the Central Bank requiring currency declarations for departing and returning Philippine residents, while still another was the granting of permission for 100 per cent of the reserves against special time deposits to consist of government securities.

At the same time that particular industries and activities were given special incentives to expand production, there were also some efforts to curtail expansionary forces on a general level. For example, the rediscount rate was increased in April from 7½ per cent to 8 per cent. In June, an additional charge of 2 per cent was levied on all Central Bank loans and advances. Thus, in effect, the rediscount rate was increased to 10 per cent. The reason given by the Central Bank for the levy was to align its rates with those prevailing in world money markets. As has been the practice after the introduction of strong restrictive measures by the Central Bank, exceptions to the 2 per cent interest charge soon appeared, including loans and advances to the government, loans to commercial banks secured by government securities and promissory notes of the Rice and Corn Administration. High-priority export activities were also excluded from the 2 per cent levy.

As is typical of the seasonal pattern in receipts and payments, during the first seven months of the year government receipts were slightly larger than disbursements. This surplus was, however, much too small to offset the large budget deficit of the last five months that was related to the presidential election in November. The net deficit for the year was P934 million—an amount over three times larger than in the previous year and roughly equal to the cumulative deficits between 1961 and 1968. Equally dramatic was the 20 per cent rise in the money supply in the last four months of 1969—from P4.0 million in August to P4.8 million in December. Of course, the large deficit and large increase in the money supply were closely related. Central Bank loans to the national government together with securities of the national government held by the Central Bank rose by P445 million in the last six months, and national-government securities held by commercial banks increased by P219 million in the same time period.

The growing destabilizing effects of the monetary and fiscal developments in the last part of the year forced the Central Bank to adopt highly restrictive policies toward the private sector. As of June 18, 1969, import letters of credit could be opened only for four categories of commodities, namely, essential producer goods, essential consumer goods, semiessential producer goods, and nonessential producer goods. Furthermore, for the four permitted types of imports a 15 per cent cutback was imposed, on June 18, on import letters of credit relative to their October 1968–March 1969 levels, and another 15 per cent was added on July 15. The level of 70 per cent of the base was held until November, when the ceiling was further restricted to 55 per cent of the base period, and the opening of letters of credit was divided into weekly allotments. For all imports other than those in the four categories mentioned, the Central Bank stipulated that its prior authorization was required.[6] Still another restrictive measure taken in November was to remove the privilege of open-account financing on imports of certain essential consumer and producer goods. These were made subject to the general rule that imports must be financed by letters of credit. Regulations on nonmerchandise trade were also tightened.[7]

One indication of the seriousness of the financial situation near the end of 1969 was that the Central Bank was forced to assume the interest burden on the foreign credit lines of the Philippine National Bank (PNB) that were associated with overdrafts of the PNB's accounts with certain U.S. commercial banks. In addition, from December until the peso was floated on February 21, 1970, there were no interbank foreign-exchange transactions, since commercial banks were required to surrender to the Central Bank foreign-exchange holdings in excess of 25 per cent of outstanding foreign-currency liabilities.

The 1966–69 period demonstrates that Philippine economic development cannot long be sustained at a high rate unless there is also a high growth rate of export earnings. Extensive credit creation and foreign borrowing can initiate periods of prosperity; but unless these measures are accompanied by exchange-rate policies designed to maintain a vigorous export sector, these periods of expanding economic activity are doomed to end suddenly as balance-of-payments problems eventually build up to a crisis.

Export Incentives.

One merit of the development efforts of the Marcos administration was the greater attention paid to expanding exports, especially of industrial products, than in previous administrations. Some of the special treatment given to export activities has already been pointed out. The Investment Incentives Act of 1967, which was aimed at stimulating production in key domestic industries as well as in export activities, is another example of this concern for increasing exports. Under the act, a Board of Investment (BOI) was established which determines the industries that qualify for special aid. Firms are registered as either "preferred" or "pioneer," the latter being those that produce new products or processes in the economy. The BOI determines the list of activities that fit these two categories of investment. The main forms of assistance to registered firms are: (1) exemption for seven years from import duties and compensating taxes on imports of capital goods or a tax credit equivalent to these taxes if the capital goods are purchased from domestic firms, (2) deduction from taxable income of all capitalized preoperating expenses, (3) accelerated depreciation of fixed assets, (4) liberal carry-over features for operating losses, and (5) deduction from taxable income of reinvested earnings. In addition to these forms of assistance, pioneer firms are exempted from paying a certain proportion (which declines over time) of all national taxes except the income tax[8] and are given special tariff protection against competing imports. In pioneer industries, 100 per cent foreign ownership is permitted unless specifically prohibited by law. However, in preferred investment areas, only firms at least 60 per cent owned by Filipinos can obtain the special privileges until three years have expired after the industry has been designated a "preferred" area of investment. If Filipinos do not enter the industry within this time period, the nationality criterion is dropped.

Registered firms that export completely finished products receive, in addition to the aids previously cited, the following tax advantages: (1) double deduction from taxable income of export-promotion expenses, (2) double deduction from taxable income of freight costs incurred in connection with exporting if Philippine ships are used or a one and one-half deduction if foreign ships are employed, and (3) a tax credit equivalent to 7 per cent of the cost of raw materials used in export production.

The Export Incentives Act of 1970 expands the aids to export firms (defined as firms with at least 50 per cent of their sales to foreign countries) in the form of: (1) a tax credit equivalent to all sales, specific, and import taxes on the raw materials and supplies used in export production, replacing item 3 above; (2) a deduction of part of the firm's export revenue from taxable items for five years; and (3) an exemption from export taxes. Under item 2 just above, taxable income can be reduced for five years by the product of the proportion of direct labor costs in total costs, the proportion of local raw materials in total costs, the number 5, and export sales.[9]

THE 1970 EXCHANGE CRISIS AND ITS AFTERMATH

Exchange-Rate Policies in 1970 and 1971.

During January and most of February 1970, the government continued its policy of sharing the responsibility for rationing the limited supply of foreign exchange with the commercial banks. The ceilings for these banks on foreign-currency letters of credit, which had been reduced in November 1969 to 55 per cent of their base-period level, were renewed at these low levels in early January, as were the special time-deposit requirements for letters of credit. Moreover, reserve requirements for commercial banks, savings banks, development banks, and rural banks were all raised two percentage points in late January. This changed the reserve requirement for commercial banks from 16 per cent to 18 per cent by March.

The balance-of-payments situation continued to worsen, however. President Marcos underscored the seriousness of the problem when he told a business group in early January: "We have unfortunately financed the foreign-exchange requirements of our development with credits of short maturities. I am told by my advisers that because of the increase in short-term debts, the total payment for interest and amortization of foreign obligations of the country this fiscal year ending June 30 will take over one-half of our export earning." [10] More specifically, outstanding public and private foreign debts amounted to more than $1.6 billion by the end of 1969, of which over $450 million was due in 1970 and two-thirds within four years. Of the debt maturing in one year, $196 million was owed by the Central Bank, $58 million by the government, and $198 million by the private sector.[11]

The only realistic method of coping with the exchange crisis was again to request financial assistance from the International Monetary Fund and to ask foreign banks to agree to longer repayment terms. An IMF consultative group arrived in the Philippines on January 10, 1970. Foreign creditors took the position that they would accept a restructuring of their debt provided the government agreed to the IMF's stabilization recommendations for correcting the country's weak financial condition and thereby obtained its third credit tranche from the fund.[12] The advice of the fund on exchange-rate policy was either to devalue significantly or float the peso.

The government chose to float the peso rather than devalue sharply, and freed the peso on February 21, 1970. This action together with the other major policies followed in 1970 and 1971 are summarized in Table 4-5. The peso-dollar rate promptly rose, from P3.90 to over P5.5, and reached P6.4 by the end of the year. At the same time that the exchange rate was permitted to move to its free-market level, the Central Bank lifted the monthly ceilings on foreign-currency letters of credit, the special time-deposit requirement, and the ban on open-account financing arrangements. Certain exchange controls remained, however. The sale of foreign exchange for imports of nonessential consumer goods still required prior approval of the Central Bank. This prior-approval requirement in effect continued the ban on imports of some 400 luxury commodities.[13] Importation by means of documents against acceptances and open-account arrangements were permitted only for periods

TABLE 4-5

Major Trade, Payments, and Related Economic Policies, 1970–71

Feb. 1970	Peso floated in foreign-exchange markets, and peso-to-dollar rate rose to P6.4 by end of year. Some exchange controls removed but exporters of major products required to convert 80 per cent of their receipts at old rate of P3.90 per dollar.
	Special export tax of 8 or 10 per cent substituted for dual exchange-rate arrangement for exporters.
	Beginning of gradual two-percentage-point rise in reserve requirement for commercial banks.
July 1970	Issuance of circular requiring most imports to be covered by letters of credit. Commercial banks voluntarily accept 30 per cent (later raised to 50 per cent) margin deposit against letters of credit.
Nov. 1970	Passage of law limiting power of the government to borrow abroad.
Aug. 1971	Central Bank imposes 15 per cent reserve requirement against margin deposit required for letters of credit.
Nov. 1971	Reserve requirement on margin deposit against letters of credit raised to 50 per cent.

not shorter than 180 days. Ceilings and limitations on the sale of foreign exchange for current invisible payments such as travel abroad and remittances of profits also continued in operation. Furthermore, the explicit approval of the Central Bank was necessary for new foreign borrowings and investments, and the remittance of the assets of emigrants was restricted.

An important feature of the new exchange system for exporters was that 80 per cent of all receipts from the leading export products, namely, logs, centrifugal sugar, copra, and copper ores and concentrates were to be surrendered to the Central Bank at the old rate of P3.90 to the dollar. The remaining 20 per cent could be sold at the free-market rate. However, in May 1970, as a result of the strong opposition of exporters, a special stabilization tax on exports was substituted for this differential exchange-rate arrangement. For logs, copra, sugar, and copper ores and concentrates, the tax on the total value of exports was set at 10 per cent. An 8 per cent tax rate was established for the following exports: molasses, coconut oil, desiccated coconut meal or cake, unmanufactured abaca, unmanufactured tobacco, veneer core and sheets, plywood, lumber, canned pineapple, and bunker fuel oil. In addition, any product whose annual export value exceeded $5 million was made subject to the 8 per cent tax during the fiscal year following attainment of this export value. However, exceptions to the stabilization tax were also made. In July

1970, exports of pineapple juice and concentrates were exempted from the tax; and shortly thereafter refined sugar, wood moldings, diesel fuel oil, and industrial fuel oil were added to the exemption list.

Another aspect of the government's stabilization efforts was the establishment by the Central Bank in July of an Exchange Stabilization Fund. Commercial banks were required to sell 10 per cent of their foreign exchange receipts directly to the Central Bank in order to provide foreign exchange for the stabilization fund. The proceeds were used to fund deposits being maintained with the consortium of creditor commercial banks in the United States.

The peso cost of a dollar remained essentially unchanged at about P6.4 throughout 1971. Controls over the ability of importers to purchase certain imports continued in effect, but there was an easing of controls for export-oriented firms and firms registered with the Board of Investment (BOI). In February, for example, export-oriented firms were permitted to import machinery and equipment by means of documents against acceptance and open-account arrangements without prior Central Bank approval, provided payment was made within 360 days. This privilege was extended, in August, to BOI-registered firms as well as to importers purchasing agricultural machinery and equipment.[14]

Some restrictive measures were put into effect, however, in the last half of the year to limit imports and neutralize excess liquidity. In late July, for example, the Central Bank issued a circular requiring all imports to be covered by letters of credit except imports by firms with a history of open-account or document-against-acceptance arrangements.

Monetary and Fiscal Policies.

In addition to permitting the peso to depreciate, the government followed a policy of monetary and fiscal restraint as part of its stabilization program. Starting on May 1, 1970, reserve requirements were raised another 2 per cent in four successive equal monthly installments of one-half per cent, with the result that by August the requirement for commercial banks was 20 per cent. Rediscounting privileges were also curtailed.[15] Other anti-inflationary steps taken at this time were to rescind all previously granted exemptions on the 2 per cent interest equalization charge imposed by the Central Bank and to increase the maximum rate of interest that banks could pay on time deposits. An important voluntary measure agreed upon later in the year by the commercial banks was the adoption of a uniform minimum margin deposit against letters of credit. The level was initially set, in July, at 30 per cent, but was raised to 50 per cent in October 1970.

During 1971, the Central Bank continued trying to exercise monetary restraint. For example, it raised the preferred rediscount rate to all rural banks for certain paper from 2 per cent to 3 per cent and also established ceilings for credit accommodations by banks to their directors, officers, or principal stockholders. Firms that were delinquent in paying off debts to government financial institutions also were required to obtain the explicit consent of the Central Bank to obtain foreign exchange. The most important policy adopted by the Central Bank, however, was the imposition in August 1971 of a 15 per cent reserve requirement on commercial banks against the 50 per cent margin deposit required for letters of credit. In late November, after some postponements, the required reserve was raised to 30 per cent.

For most of 1970 the monetary authorities succeeded in halting any further increases in the money supply and were even able to decrease it for a time. However, by November the money supply had passed its January level and in December was 6.2 per cent above the December 1969 figure. The rise continued into 1971, with the result that the money supply as of December 1971 was 10.3 per cent greater than its December 1970 level.

The national government managed to achieve a surplus of P143 million in its operational cash transactions in 1970, but it incurred a deficit of P91 million in 1971. Both the internal and external public debt also increased over these two periods. The internal debt rose 8 per cent in 1970, mainly due to a net increase in Treasury bills and the issuance of new bonds for infrastructure investments by the various development corporations of the government. During 1971 the internal debt expanded another 10 per cent as an intensification of spending on infrastructure and social services took place.

Much of the increase in the external debt of the government and the monetary institutions from $828 million in December 1969 to $1,041 million in December 1970 (a 25 per cent increase) was related to the need for adequate working balances of foreign exchange after the exchange crises of late 1969. At the time that the peso was floated, the Central Bank obtained its third credit tranche of $27.5 million from the IMF, a $40 million credit from the Federal Reserve Bank of New York, a $40 million loan from the First National City Bank of New York, and $18.5 million under the country's special drawing rights at the IMF. Later in 1970 the Central Bank secured credits of $35 million from Japanese banks and $10 million from Manufacturers Hanover Trust of New York. Furthermore, in June the Central Bank successfully completed negotiations for the restructuring of $247 million of debt with U.S banks and $27 million with European banks. The U.S. debt, most of which had been due in 1970, was consolidated into a loan payable over a six-year period. After repayments during the year, the level of the Central Bank's external debt on December 31, 1970, was $102 million higher than a year earlier, and the country's total external debt was $140 million higher. However, during 1971 the total external debt increased only $34 million, or 3 per cent.[16]

In an effort to prevent future episodes of excessive foreign borrowing by the government, limits on borrowing from abroad were imposed under a law (R.A. 6142) passed in November 1970. Under this law the government is permitted to borrow only $1 billion from abroad at a rate of not more than $250 million a year. The credits also must have a minimum of 10 years' maturity, and the interest paid must not exceed the rate charged by international financial institutions. It is further stipulated that government guarantees of foreign borrowing by other institutions may not exceed $500 million.

Besides the upper bound set to government borrowing under the act, it is stated that the payment of amortization and interest on the country's *total* external debt must not exceed 20 per cent of average foreign-exchange receipts over the preceding three years. To implement this provision, the Central Bank issued Circulars 315 and 316, in December 1970, establishing guidelines on foreign borrowings, i.e., any credit over 360 days. First, the Central Bank reiterated the requirement that foreign loans to the private sector must have its prior approval. Next, the bank established the following minimum repayment terms for loans of differing magnitudes: (a) loans of $250,000 or less should have a maturity of at least five years; (b) loans of between $250,000 and $500,000 should be repayable in no less than eight years; and (c) loans over $500,000 should have a maturity period of at least twelve years. However, applications for loans exceeding $500,000 with at least an eight-year maturity period inclusive of a three-year grace period on repayments of principal should be approved for export industries. Loans to overcrowded industries or to firms in arrears with government financial institutions were not to be approved by the Central Bank. Finally, it was stipulated in Circular 315 that the interest rates on foreign borrowings should not be more than 2 per cent above the prime rate of the lending country.

Both the law passed by Congress and the circulars issued by the Central Bank can only be justified as emergency measures. Tying the length of the repayment period to the size of a loan is, for example, a highly arbitrary and inefficient long-run method of preventing excessive foreign borrowing.

Economic Effects of the Currency Depreciation.

As is indicated in Table 4-6, the dollar price of the peso increased significantly immediately after it was permitted to seek its free-market level on February 21, 1970. The rate thereafter continued to rise gradually, and in December 1970 it was fixed by agreement among the commercial banks. There was a slight decline in August and September 1971, but by December 1971, the rate had returned to its December 1970 level.

The fear of further intensification of the social unrest that was triggered by price rises associated with the currency depreciation apparently accounts

TABLE 4-6

Foreign-Exchange Rates, 1970–71
(pesos per U.S. dollar)

1970	January	3.902		September	6.338
	February 1–20	3.906		October	6.402
	February 21–28	5.556		November	6.402
	March	6.057		December	6.402
	April	6.132	1971	January–July	6.402
	May	6.082		August	6.391
	June	6.173		September	6.379
	July	6.203		October–November	6.400
	August	6.238		December	6.402

SOURCE: Central Bank of the Philippines, *Central Bank News Digest*, 1970 and 1971.

for the decision to fix the dollar value of the peso. Since excess demand conditions developed soon after the peso was stabilized, bankers again began rationing foreign exchange among established customers. They also began bidding among themselves for exporters' dollars, using such devices as offering exporters lower lending rates than prevailed in the general market. Of course, in effect this depreciated the peso still further.

Exports quickly increased after the currency depreciation. Their value had remained at around $850 million from 1966 through 1969 but rose 24 per cent to $1,062 million in 1970. In volume terms, exports, which had actually fallen about 5 per cent between 1966 and 1969, rose 14 per cent between 1969 and 1970. These favorable performances in value and volume terms continued in 1971. The value of exports rose 5 per cent, to $1,122 million, while the volume of exports increased 13 per cent. The balance of trade also improved dramatically. Because of the government's policies of monetary and fiscal constraint as well as its continued controls over some foreign-exchange payments, the value of imports declined by over $40 million between 1969 and 1970. The deficit on the trade account fell from $276 million in 1969 to $28 million in 1970. In 1971, the result was not quite as satisfactory, as imports rose to $1,186 million, but the trade deficit was still only $64 million.

Among individual items, coconut products exhibited an especially impressive export performance over the two-year period, 1970–71. The export quantities of these products from 1969 to 1971 rose as follows: copra, 34 per cent; desiccated coconut, 35 per cent; coconut oil, 96 per cent; and copra meal or cake, 63 per cent. The volume of exports of copper concentrates continued their upward trend, increasing 40 per cent over the two-year period. Bananas also became one of the ten leading exports, expanding in volume nearly 900 per cent. Sugar exports also performed well, rising 37 per cent in the period. Exports of logs and lumber, pineapples, and plywood did not change significantly. Another favorable development on the export side was the 26 per cent increase in the value of manufactured goods other than the processing of such products as sugar and coconuts. However, these exports still amounted to less than 0.7 per cent of all commodity exports.

NOTES

1. Central Bank of the Philippines, *Annual Report*, 1966, p. 1.

2. The new categories introduced into the Central Bank's commodity classification system at this time were defined as follows: unclassified producer (consumer) goods were goods produced in sufficient quantity to meet local demand and of acceptable quality and offered at competitive prices; semiunclassified producer (consumer) goods were goods that were produced locally but which did not fully satisfy the criteria for unclassified goods as to quantity, quality, or price. All goods not otherwise classified in the other categories were included in these two categories.

3. Sixto K. Roxas, "Exchange Rate Experience and Policy in the Philippines Since World War II," in H. Grubel and T. Morgan, eds., *Exchange Rate Policy in Southeast Asia* (Lexington, Mass.: Heath, 1973), p. 58.

4. Specifically, the following export activities were excluded from these credit ceilings:

a. The production of logs and lumber; sugar, copra, copra meal or cake; copper concentrates; coconut oil and desiccated coconut; abaca; plywood and veneer; canned pineapple; and other agricultural, forestry, marine, and base metal products;

b. The processing or manufacture of finished products for exportation, with an export potential as evidenced by export records or contracts and with an indigenous raw materials content of at least 70 per cent;

c. The processing or manufacture of finished products in which domestic value added is less than 50 per cent, but of which at least 50 per cent of total output is destined for export.

5. Later in the year, imports of machinery and spare parts for use by local wearing apparel and embroidery firms were added to the list of industries exempted from this requirement and also from the requirement that all imports be financed by letters of credit.

6. Imports of capital goods valued at over $20,000 were permitted after July 1969 only on a deferred payment basis (20 per cent down and payment terms of at least three years), and in November, prior approval of the Central Bank was required for imports of any single unit of machinery or equipment valued at over $50,000.

7. Only $500 per year could be obtained per adult resident of the Philippines for travel to North and South America, Europe, Japan, Australia, New Zealand, Africa, and the Middle East, and a $200 limit was set for travel to Hong Kong, Taipei, Okinawa, Guam, and other neighboring countries. In addition, formal regulations covering securities transactions involving foreign exchange were established.

8. An analysis by the BOI staff of selected income statements of proposed firms with respect to the extent of the aid provided by the act gives the following percentages for the ratio of the increase in profits due to tax assistance to the firm's total costs:

mechanical grain driers, 3; globe and gate valves, 3; hand pump manufacturing, 0.6; malleable iron fittings, 5; roller bearing units, 3; files, 7; and small gasoline engines, 7.

9. If one assumes all the revenue of the firms in the BOI sample was export revenue, the combined effect of the Investment Incentives and Export Incentives Acts gives the following percentage ratios for the increase in profits to the firm's total costs: mechanical grain driers, 8; globe and gate valves, 9; hand pump manufacturing, 2; malleable iron pipe fittings, 8; roller bearing units, 6; files, 7 (unchanged since these contain no raw materials); and small gasoline engines, 8.

10. Speech by President Marcos to Rotary Club of Manila, January 8, 1970, as reported in *Central Bank News Digest,* February 10, 1970, p. 6.

11. G. V. Soliven, "Management of External Debt," reported in *Central Bank News Digest,* July 13, 1971, p. 3.

12. G. S. Licaros, Speech before Rotary Club, February 26, 1970, as reported in *Central Bank News Digest,* March 10, 1970, p. 2.

13. The requirements that imports of capital goods with a unit value of over $20,000 be made only on a deferred payment basis and that importations of single units of machinery or equipment valued at over $50,000 could be made only with prior Central Bank approval also were continued.

14. In September, the requirement that monthly imports exceeding $50,000 receive prior Central Bank approval was also lifted for these firms. At the same time, imports of nonagricultural machinery and equipment in excess of $50,000 monthly were also permitted for firms not qualifying as export-oriented or registered with the BOI, provided the capital goods did not add to capacity in industries listed as overcrowded.

15. Concurrent with the freeing of the peso, the rediscount ceiling for domestic commercial banks was reduced from 125 per cent of paid-up capital plus 90 per cent of other net worth items as of June 20, 1967, to 100 per cent of paid-up capital as of December 31, 1969. That this change represented a reduction in rediscount ceilings was reported by Governor G. Licaros, "Impact of the Stabilization Program on the Development of the Philippine Economy" (Speech reported in *Central Bank News Digest,* November 3, 1970), p. 3.

16. In this period the Central Bank's external debt decreased $48 million, the national government's rose $34 million, and the volume of external credits extended to government corporations rose $48 million.