Volume Title: Developing Country Debt and Economic Performance, Volume 3: Country Studies - Indonesia, Korea, Philippines, Turkey

Volume Author/Editor: Jeffrey D. Sachs and Susan M. Collins, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-30455-8

Volume URL: http://www.nber.org/books/sach89-2

Conference Date: September 21-23, 1987

Publication Date: 1989

Chapter Title: External Debt and Debt Management

Chapter Author: Robert S. Dohner, Ponciano Intal, Jr.

Chapter URL: http://www.nber.org/chapters/c9052

Chapter pages in book: (p. 503 - 523)

increased by the large use of foreign borrowing and the preference of external lenders for government entities and government guarantees.

Heavy state involvement in the financial sector encouraged the government to use public financial institutions for fiscal purposes. The corporate rescue operations of the early 1980s were conducted primarily through PNB, DBP, GSIS, and indirectly through the central bank. This had the effect of hiding the true cost of the rescue operations, as well as substantially weakening the portfolios of the major financial institutions. By 1985 and 1986 the fiscal problem would be primarily a public financial institution problem, as we will explain in detail in chapter 7.

Philippine financial markets contributed to the debt crisis; they also made adjustment to the crisis more difficult, as government demands for financial resources nearly starved the private sector in the adjustment episode. In chapter 7 we take up the adjustment period in detail, but before that we examine the one remaining piece of the Philippine debt crisis story, the accumulation and management of the external debt.

6 External Debt and Debt Management

The 1970s opened with an external debt crisis in the Philippines that was in some ways similar to the current crisis. Expansionary policy during the first Marcos administration, coupled with heavy external borrowing on short term, led to the crisis. The debt/GNP ratio for the Philippines rose from 10 percent in 1965 to 22 percent by 1969, and debt maturing within the next year amounted to one quarter of total external debt. In tandem with an IMF stabilization program and a float of the peso, the Philippines negotiated longer maturities for much of the outstanding short-term debt of the public sector.

The crisis led to a number of changes in external debt policy. Republic Act 6142 (November 1970) established a comprehensive system of control and information for foreign borrowing. Under the system all external borrowing by the public or the private sector, except short-term borrowing by the commercial banking sector, required prior approval of the Monetary Board.[1] The Management of External Debts and Investment Accounts Department (MEDIAD) was set up within the central bank to screen applications for external borrowing. Applicants were required to submit information on the proposed project and its likely returns, as well as details of the financing involved. The central bank could, and did, set minimum requirements for maturities and grace periods, as well as maximum interest rates and spreads on foreign loans. All transactions on external loans—drawings, interest and principal payments, and refinancings—had to be reported to MEDIAD, which maintained statistics on Philippine external debt.

In addition to the approval and reporting requirements, the act established a statutory limitation on debt service, and therefore implicitly, on total external indebtedness. Debt service payments were not to exceed 20 percent of average foreign exchange inflows of the three preceding years. In 1970 the Philippines was above this level, but the statutory limitation was achieved by 1972.

The monitoring and control system covered all nonmonetary debt, defined to include all direct borrowings of the nonbanking sector and medium- and long-term funds borrowed by the banking sector and then lent on to the nonbanking sector. Short-term liabilities of the banking sector were not under the control of MEDIAD and were not generally included in Philippine debt statistics prepared before the 1980s.[2] In fact, external borrowing by the banking sector has generally been encouraged through the swap facilities made available to commercial banks by the central bank and through the Foreign Currency Deposit System.

The Foreign Currency Deposit System was established in 1970 to attract offshore funds, including those held by Philippine residents, to the country and to develop the Philippines as a financial center. Subsequent modifications of the rules governing the system in 1976 led to rapid growth in the rest of the decade. Under the Foreign Currency Deposit System domestic banks were allowed to create separate accounting units called foreign currency deposit units (FCDUs), which could accept deposits in foreign currency from residents or nonresidents. Secret accounts were permissible, and deposits could be withdrawn and transferred out of the country without restriction. FCDUs could make foreign currency loans to residents or nonresidents and could make peso loans by exchanging foreign currency with the central bank under its swap facilities.[3] FCDUs were considered part of the Philippine banking system, and their liabilities were included in (banking system) external debt. This was the case even if the deposits came from Philippine residents. The liabilities of FCDUs grew rapidly in the late 1970s and early 1980s to a level of just over $8 billion in 1983.[4]

In addition to the Foreign Currency Deposit System, which was restricted to domestic and foreign-owned commercial banks operating in the country, provisions were made for foreign commercial banks to set up offshore banking units (OBUs) in the Philippines. These units could accept foreign currency deposits from external sources and make loans to nonresidents of the Philippines, with minimal restrictions by the central bank. Lending to Philippine residents in foreign currency was also permissible, but had to be approved by the central bank as a regular external borrowing. OBUs are treated as foreign commercial banks by the Philippines, and their loans to domestic residents, but not their liabilities, are included in Philippine external debt.

6.1 External Borrowing in the 1970s

Summary figures on Philippine external debt are presented in table 6.1. The impact of the successful adjustment period in the early 1970s is clearly seen in the debt figures in the table. The current account improved dramatically during these years and registered a surplus of 5 percent of GNP in 1973. Nonmonetary external debt grew modestly, and both the debt/GNP and debt/export ratios fell dramatically. Maturities on nonmonetary debt lengthened, although the share of short-term debt in the total external debt of the Philippines increased as the banking sector resumed normal operations and banking sector liabilities grew.

The next four years, 1974–78, saw a surge in foreign borrowing in the Philippines, a consequence of the first oil shock and the acceleration of the country's development program. Outstanding nonmonetary debt tripled during this period. The growth in real terms was substantially less because of inflation, but both the debt/GNP and the debt/export ratios increased considerably. By the end of the 1970s, indicators of Philippine foreign debt had reached high but certainly not alarming levels. The debt/GNP ratio in the Philippines in 1979 was comparable to that of Korea and Indonesia and somewhat below the Latin American average. The Philippine debt/export ratio was well above Korea's, but well below most of Latin America (see table 6.6 below).

Several changes in the characteristics of Philippine debt took place during the last half of the 1970s. The first was a marked shift in external borrowing toward the public sector. After falling in the early 1970s, the share of public sector debt rose sharply, reaching two-thirds by the end of the decade (table 6.2).

As was the case for other LDC borrowers during the 1970s, there was a shift in the Philippines toward commercial sources of finance and toward debt with floating interest rates. Between 1976 and 1980 the share of banks and other financial institutions in the Philippine credit mix rose to just over half, shown in table 6.3. But the Philippines put considerable effort into diversifying its sources of finance. One source was the international bond market, which the Philippines tapped for about 10 percent of its medium- and long-term funding. The Philippines also assiduously courted multilateral and bilateral sources during the 1970s, receiving an increasing share of funding from these two. Major official sources for the Philippines were the World Bank, the Asian Development Bank, and the U.S. and Japanese governments. Creditor breakdowns for earlier years in the 1970s are available for medium- and long-term debt of the public sector and show the same patterns (table 6.4). Aid from official sources was largely coursed

Table 6.1 **Philippine External Debt (in millions of U.S. dollars)**

	1970	1972	1973	1974	1975	1976	1978	1979
Nonmonetary debt	2,138	2,221	2,306	2,726	3,422	5,120	8,189	9,899
Medium & long term	1,779	1,901	2,025	2,395	2,985	4,405	6,932	8,086
IMF obligations	108	145	139	131	238	450	626	718
Other	1,671	1,756	1,886	2,264	2,747	3,955	6,306	7,368
Short term	359	320	281	331	438	715	1,257	1,813
Monetary sector debt	159	511	580	1,029	1,517	1,648	2,505	3,453
Total debt	2,297	2,732	2,886	3,755	4,939	6,768	10,694	13,352
Total debt								
As % of GNP	33.2	32.6	27.0	25.5	31.3	37.5	44.5	45.2
As % of exports	174	188	114	106	154	196	218	213
Monetary sector debt as % of total	6.9	18.7	20.1	27.4	30.7	24.3	23.4	25.9
Short-term debt								
As % of total debt	22.6	30.4	29.8	36.2	39.6	34.9	35.2	39.4
As % of nonmonetary debt	16.8	14.4	12.2	12.1	12.8	14.0	15.4	18.3
GNP US$	6,914	8,381	10,685	14,711	15,789	18,037	24,033	29,553

	1980	1981	1982	1983	1984	1985	1986	1987
Nonmonetary debt	12.318	14.990	17.601	19.468	20.211	21.270	25.668	26.702
Medium & long term	9.770	11.326	13.141	15.412	15.926	17.679	22.878	24.857
IMF obligations	936	1.030	908	1.013	844	1.115	1.243	1.183
Other	8.834	10.296	12.233	14.399	15.082	16.564	21.635	
Short term	2.548	3.664	4.460	4.056	4.285	3.591	2.790	1.845
Monetary sector debt	4.934	5.903	7.076	5.348	5.207	4.982	2.588	1.947
Total debt	17.252	20.893	24.677	24.816	25.418	26.252	28.256	28.649
Total debt								
As % of GNP	49.0	54.4	62.8	72.7	80.6	81.7	94.1	84.1
As % of exports	215	242	308	305	317	332	327	311
Monetary sector debt as % of total	28.6	28.3	28.7	21.6	20.5	19.0	9.2	6.8
Short-term debt								
As % of total debt	43.4	45.8	46.7	37.9	37.3	32.7	19.0	13.2
As % of nonmonetary debt	20.7	24.4	25.3	20.8	21.2	16.9	10.9	6.9
GNP US$	35.218	38.435	39.278	34.136	31.517	32.124	30.021	34.056

Source: Philippine central bank, MEDIAD and Financial Plan Data Center.

Table 6.2 **Philippine Nonmonetary External Debt, Public and Private Sector (in millions of U.S. dollars and percentages)**

	1970	1972	1973	1974	1975	1976	1978	1979
Private sector debt								
Medium & long term	919	983	1,041	1,213	1,411	1,812	2,091	2,072
Short term	175	297	262	320	409	568	936	1,247
Public sector debt								
Medium & long term	751	762	845	1,048	1,316	2,120	4,192	5,211
IMF obligations	108	145	139	131	238	450	626	718
Short term	184	23	19	11	28	147	321	566
Total nonmonetary debt	2,137	2,210	2,306	2,723	3,402	5,097	8,166	9,814
Percentage shares:								
Nonmonetary debt								
Private	51.2	57.9	56.5	56.3	53.5	46.7	37.1	33.8
Public	48.8	42.1	43.5	43.7	46.5	53.3	62.9	66.2
Medium- & long-term debt								
Private	55.0	56.3	55.2	53.6	51.7	46.1	33.3	28.4
Public	45.0	43.7	44.8	46.4	48.3	53.9	66.7	71.6
Short-term debt								
Private	48.9	92.8	93.2	96.7	93.6	79.4	74.5	68.8
Public	51.1	7.2	6.8	3.3	6.4	20.6	25.5	31.2

	1980	1981	1982	1983	1984	1985	1986	1987
Private sector debt								
Medium & long term	2,454	2,761	3,229	3,125	2,711	2,643	3,692	4,020
Short term	1,601	1,802	2,123	1,949	2,092	2,405	2,199	1,259
Public sector debt								
Medium & long term	6,292	7,443	8,874	10,951	12,173	13,009	17,943	19,654
IMF obligations	936	1,030	908	1,013	844	1,115	1,243	1,183
Short term	947	1,863	2,337	2,107	2,193	1,186	591	586
Total nonmonetary debt	12,230	14,899	17,471	19,145	20,013	20,358	25,668	26,702
Percentage shares:								
Nonmonetary debt								
Private	33.2	30.6	30.6	26.5	24.0	24.8	23.0	19.8
Public	66.8	69.4	69.4	73.5	76.0	75.2	77.0	80.2
Medium- & long-term debt								
Private	28.1	27.1	26.7	22.2	18.2	16.9	17.1	17.0
Public	71.9	72.9	73.3	77.8	81.8	83.1	82.9	83.0
Short-term debt								
Private	62.8	49.2	47.6	48.1	48.8	67.0	78.8	68.2
Public	37.2	50.8	52.4	51.9	51.2	33.0	21.2	31.8

Source: Central bank, MEDIAD.

Note: The classification system for nonmonetary debt differs slightly starting in 1986. Figures for 1985 and earlier are approximately, but not strictly, comparable.

Table 6.3 **Nonmonetary Medium- and Long-term Debt Characteristics (percentage shares)**

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1985	1986	1987
Total medium- and long-term debt	3,932	5,024	6,283	7,283	8,746	10,204	12,103	14,076	14,884	15,652			
Total external debt											26,252	28,256	28,649
Creditors:													
Multilateral institutions	10.4	11.9	13.4	15.2	16.2	18.9	19.1	21.2	22.4	22.5	17.1	16.6	17.6
Governments	7.1	12.0	12.7	10.5	9.4	10.5	10.2	9.3	9.4	11.1	10.9	13.9	18.2
Bonds	9.4	10.0	12.4	12.2	11.0	9.9	8.3	7.7	6.7	5.9	na	na	na
Banks, other financial institutions	41.3	42.1	42.8	50.3	51.0	50.4	52.0	51.2	51.1	50.9	58.2	57.3	53.1
Suppliers credits	31.8	23.9	18.7	11.8	12.5	10.3	10.4	10.7	10.3	9.5	12.4	10.9	8.2
Maturity:													
1–5 years	7.2	6.1	4.1	2.5	1.9	1.1	1.4	1.3	3.0	47.8			
5–12 years	53.3	58.2	57.3	56.7	56.9	53.7	51.5	47.5	44.5				
Over 12 years	39.4	35.7	38.6	40.8	41.2	45.1	47.1	51.2	52.5	52.1			
Interest Rate:													
Fixed	82.8	74.9	73.1	68.4	63.4	61.0	56.6	60.1	60.7	58.8			
Floating	17.2	25.1	26.9	31.6	36.6	39.0	43.4	39.9	39.3	39.5			
Borrower:													
Public	53.9	56.9	66.7	71.6	71.9	72.9	73.3	77.8	81.8	83.1			
Private, public guarantee	14.1	11.0	7.1	6.9	6.8	5.9	7.3	7.3	6.3	4.9			
Private, nonguaranteed	32.0	32.0	26.2	21.6	21.3	21.1	19.4	14.9	11.9	12.0			

Source: Central bank, MEDIAD. Data on total external debt from the central bank, Financial Plan Data Center.

Table 6.4 **Public Sector Medium- and Long-Term Debt by Creditor (in millions of U.S. dollars and percentages)**

	1970	1975	1979	1980	1981	1982
Total medium- & long-term debt	1,491	2,789	7,230	8,918	10,338	11,992
Public sector	572	1,377	5,159	6,464	7,578	8,836
Percent shares:						
Multilateral	21.0	24.6	22.9	23.2	26.5	26.0
Bilateral	19.4	39.1	21.9	19.7	19.3	17.5
Bonds	1.9	1.6	15.2	13.9	11.2	9.9
Financial institutions	46.7	29.5	35.2	38.7	38.9	42.9
Supplier credits	10.9	5.1	4.9	4.5	4.0	3.7

Source: World Bank (1984a), table A.8.

Note: This table is based on an older data series which has since been revised. Comparable breakdowns from revised data are not available.

through the public sector, and thus has a much larger share among the creditors shown in table 6.4.

As we point out in table 6.3, the proportion of Philippine medium- and long-term debt at floating interest rates doubled to 37 percent by the end of the decade. However, the use of floating rate debt was not as extensive in the Philippines as it was in other medium income countries, and at 40 percent in the early 1980s it was well below that of Latin American debtors. The Philippines was also able to make heavier use of bilateral and multilateral loans than were Latin American debtors, where the share of debt to official creditors averaged 18 percent.[5]

Philippine authorities paid close attention to debt management during most of the 1970s. Short-term debt as a proportion of nonmonetary debt was reduced steadily until the mid-1970s, particularly short-term debt of the public sector. Within medium- and long-term debt, there was a continuing shift toward longer maturities (see table 6.3). The Philippines also used the opportunities presented in 1978 and 1979 to refinance a portion of existing loans and lengthen maturities. By the late 1970s, the average maturity on fixed term credits was just over 13 years.[6]

Although it is difficult to measure or prove, the Philippines probably received better terms on foreign borrowing through the minimum terms and queuing that were enforced through the approval process. In order to limit the number of approaches to the market, the central bank borrowed in large amounts in its own name for smaller and less well-known Philippine applicants. Through this Consolidated Foreign Borrowing Program, the central bank borrowed $2.4 billion between 1978 and 1983. About two-thirds of the funds raised went to public sector entities (including DBP) and the rest to private sector applicants.[7] Although the loans carried the guarantee of the central bank, the foreign exchange risk was borne by the ultimate recipients of the loans.

Although no single indicator adequately describes the burden and risk associated with a given level of external debt, the most common one used is the ratio of debt service payments to export earnings. Despite the rapid accumulation of external debt during the 1970s, there was only slight movement of the Philippine debt service ratio (defined here as interest on nonmonetary debt, plus principal repayments on medium- and long-term debt divided by exports of goods and services). The debt service ratio declined from a level of 30 percent in 1970 to below 20 percent by 1973 (table 6.5). The ratio varied somewhat, but maintained a level of about 18 percent between 1975 and 1980. International comparisons, using a definition of the debt service ratio that does not include service exports, are shown in table 6.6. Here the Philippines shows up with high debt ratios relative to the other Asian countries, but generally moderate ratios when comparisons are made to Latin American countries or other LDCs outside the region. At the end of the 1970s the Philippines was a high external debt country but, on macro indicators, not a worrisome one.

A second debt service ratio, unique to the Philippines, is important in discussing Philippine debt. This ratio was defined by Republic Act 6142 in 1970 and influenced, and to some extent constrained, Philippine behavior. In addition, it may have misled domestic policymakers and external creditors about the debt risk of the Philippines. The statute limited total debt service payments to less than 20 percent of total foreign exchange receipts. The numerator in this statutory debt service ratio included principal and interest payments on medium- and long-term debt, IMF obligations, and short-term debt of fixed maturity. The definition excluded debt service on revolving credits and on short-term banking system liabilities. The denominator included all external receipts on a cash basis, including capital inflows, SDR allocations, and monetization of gold. In the original ratio, foreign exchange receipts were to be the average of the three preceding years, but this was later amended by presidential decree to refer to just the preceding year.

The statutory debt service ratio was unusual in that it included capital inflows as well as current earnings in the denominator. What this meant was that additional foreign borrowing could actually *lower* the statutory ratio in the following year, if the interest rate plus rate of amortization was below the current level of the statutory ratio. In addition, the statutory ratio left out short-term revolving credits, which became a major part of debt accumulation in the 1980s. The statutory ratio tracked the conventional debt service ratio closely during the 1970s, as shown in table 6.5, but the two measures diverged greatly during the 1980s. Between 1980 and 1982, when the conventional debt service ratio almost doubled, the statutory ratio increased by a mere 4 percent.

Table 6.5 **Debt Service on Philippine External Debt (in millions of U.S. dollars and percentages)**

	1970	1972	1973	1974	1975	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Medium- & long-term debt																
Principal	271	264	378	369	355	378	545	634	692	794	1,060	1,119	1,225	713	890	1,027
Interest	115	120	125	152	234	236	440	626	975	1,374	1,990	1,985	2,257	2,208	2,046	2,226
Total debt service	386	384	503	521	589	614	985	1,260	1,667	2,168	3,050	3,104	3,482	2,921	2,936	3,253
Debt service ratio																
As % of exports of goods and services	29.2	26.4	19.9	14.6	18.4	14.5	20.1	20.1	20.8	25.2	38.1	38.2	43.4	36.9	34.0	35.3
Statutorily defined	34	19	20	20	17	13.7	18	18.6	18.7	19.7	19.4	19.1	na	na	na	na
Interest as % of debt service	29.8	31.3	24.9	29.2	39.7	38.4	44.7	49.7	58.5	63.4	65.2	63.9	64.8	75.6	69.7	68.4

Source: Central bank, MEDIAD and Financial Plan Data Center.

Table 6.6 Comparative Debt Ratios, 1979 and 1986

1979				1986			
Total Debt/GNP		Total Debt Service as % of Exports		MLT Debt[a]/ GNP Ratio		Debt Service on MLT Debt[a] as % of Exports	
Egypt	62.8	Mexico	76.9	Chile	120.1	Argentina	64.1
Israel	61.2	Brazil	43.8	Malaysia	77.0	Algeria	54.8
Algeria	49.1	Chile	35.4	Mexico	76.1	Mexico	51.5
Peru	47.2	Morocco	29.4	Philippines	72.2	Brazil	41.8
Venezuela	43.4	Argentina	27.3	Israel	72.1	Venezuela	37.4
Pakistan	40.7	Algeria	26.6	Venezuela	66.9	Chile	37.1
Morocco	40.3	Peru	24.5	Egypt	58.8	Indonesia	33.1
Philippines	32.4	Philippines	24.3	Argentina	51.7	Turkey	32.4
Chile	31.9	Pakistan	20.7	Peru	50.5	Israel	27.5
Korea	31.6	Venezuela	20.4	Indonesia	49.7	Pakistan	27.2
Bangladesh	29.6	Turkey	20.1	Bangladesh	47.5	Thailand	25.4
Mexico	29.4	Korea	16.8	Turkey	42.3	Bangladesh	25.1
		Egypt	16.4	Brazil	37.6	India	24.6
NOLDCs[b]	21.2			Korea	36.1	Korea	24.4
Thailand	19.4	NOLDCs[b]	15.0	Pakistan	36.0	Egypt	23.8
Turkey	19.4	Indonesia	14.5	Thailand	35.2	Philippines	21.3
Malaysia	19.0	Bangladesh	11.2	Algeria	24.8	Peru	20.5
Argentina	15.1	Thailand	8.2	India	15.1	Malaysia	20.0
India	12.9	Malaysia	5.5				

Source: Campbell (1982), and World Bank, *World Debt Tables* 1980 and *World Development Report* 1981, 1988.

[a]Medium- and long-term debt.

[b]Nonoil exporting less developed countries.

6.2 Foreign Borrowing and Debt Management in the 1980s

The relatively sanguine position of the Philippines at the end of the 1970s changed extremely rapidly during the early 1980s.The current account deficit widened sharply as the second oil price shock, the fall in commodity prices, and the rise in world real interest rates hit the country. Once again the Philippines adopted a countercyclical policy, increasing the public investment program to maintain domestic incomes. The budget deficit swelled further as a a result of rescue operations mounted for domestic firms in the wake of the Dewey Dee crisis and the failure of crony and capital-intensive firms.

This was also a period of increasing opposition to the Marcos regime. A number of protests and bombings occurred in 1980, and a wave of strikes took place after the lifting of martial law in early 1981. Capital flight, a continual phenomenon in the 1970s, increased dramatically in 1981. Errors and omissions in the balance of payments turned sharply negative in that year, a $500 million dollar turnaround from 1980 equivalent to 35 percent of the capital account.

The combined result of these events was a very rapid increase in external debt during a period of much higher real interest rates. The debt/GNP ratio rose from 35 percent in 1980 to 56 percent in 1983. The debt service ratio, which had remained almost constant during the last half of the 1970s, skyrocketed from 1980 to 1983; it jumped from 21 to 38 percent, making the Philippines an obvious problem debtor.

Four factors explain the extraordinary rise of the debt service ratio during the early 1980s. The first is the increase in world interest rates. In 1980 47 percent of Philippine nonmonetary debt was short-term debt or debt contracted at floating interest rates.[8] As world interest rates rose, so did debt service. One rough measure of this effect is interest payments during the year divided by the average level of outstanding debt during the year; this rose from 5.7 percent in 1979 to 9.5 percent in 1982.

The second reason behind the sharp rise in the debt service ratio was a reduction in export earnings. Between 1981 and 1982 the dollar value of goods and services exports fell by 7 percent after having risen by an average of 14 percent per year from 1974 to 1980. Export receipts increased only slightly during 1983 and then fell again during 1984. The decline was sharpest for merchandise exports, which fell by 14 percent between 1980 and 1983. Service receipts, which accounted for almost one-third of exports, leveled off in 1981. The Philippines was hit by the appreciation of the U.S. dollar, which weakened international commodity prices in dollar terms. There was little relief on the debt side, since three-quarters of Philippine external debt was in dollars and most of the rest in Japanese yen, also a relatively strong currency (table 6.7).

Table 6.7 **Philippines Fixed-term, Nonmonetary External Debt by Currency of Repayment (in millions of U.S. dollars)**

	1979	1980	1981	1982	1983	1984[a]	1985[b]
U.S. dollar	6.016.5	7,412.7	8.895.1	10.343.5	11,902.4	11.931.3	13.163.9
Deutsche mark	194.3	163.7	138.2	164.5	230.7	218.0	183.2
Japanese yen	1.320.7	1.558.5	1.824.4	1.987.8	2.402.7	2.630.3	2.458.9
Pound sterling	106.3	98.7	102	74.9	44.2	77.1	50.6
French franc	252.7	238.2	176.7	172.1	88.1	133.7	80.0
Others	224.4	237.8	235.9	340.0	466.5	737.6	564.4
Total	8.114.9	9.709.6	11.372.3	13.082.8	15.134.6	15.728.0	16.501.0
Percentages:							
U.S. dollar	74.1	76.3	78.2	79.1	78.6	75.9	79.8
Deutsche mark	2.4	1.7	1.2	1.3	1.5	1.4	1.1
Japanese yen	16.3	16.1	16.0	15.2	15.9	16.7	14.9
Pound sterling	1.3	1.0	0.9	0.6	0.3	0.5	0.3
French franc	3.1	2.5	1.6	1.3	0.6	0.9	0.5
Others	2.8	2.4	2.1	2.6	3.1	4.7	3.4

Source: Central bank. MEDIAD.

[a]Excludes short-term loans ($144 million total in 1984)

[b]Excludes short-term loans. and excludes Central Bank assumed obligations amounting to $266 million.

But Philippine external borrowing increased to a much greater extent than indicated by the worsening of the current account deficit, as domestic residents shifted their own capital overseas. Capital flight has long been a feature of the Philippine economy, but the scale increased dramatically in the early 1980s in response to domestic political and economic uncertainty and the increasing overvaluation of the Philippine peso. In table 6.8 we present two measures of capital flight in the Philippines. The first (col. 1–5) is the gap between total external borrowing and the recorded uses of foreign exchange in the Philippine economy. The second measure (col. 6–7) is a narrower definition and includes only errors and omissions from the balance of payments.[9] Both measures show a sharp increase in capital outflows starting in 1981, two years before the Philippines declared a moratorium. During 1981 and 1982 the difference between total external borrowing and identified uses of foreign exchange reached $1.85 billion per year, or 3.4 percent of GNP.

The measures in table 6.8 understate the true extent of capital flight in the Philippines, since much of it has occurred through manipulation of trade invoices, primarily underinvoicing of exports. Comparing recorded exports of the Philippines and imports from the Philippines as recorded by its trading partners shows a similar increase in capital flight starting in 1980 and averaging approximately $690 million a year (1.3 percent of GNP) for 1980

Table 6.8 **Philippine Capital Flight, Balance of Payments Measures (in millions of U.S. dollars)**

	External Debt Increase (1)	Current Account Deficit (2)	Other Uses of Foreign Exchange[a] (3)	Capital Outflow (4)	Cumulative Capital Outflow (5)	Errors and Omissions (6)	Cumulative (7)
1971	96	3	137	−44	−44	230	230
1972	339	−9	230	118	74	136	366
1973	154	−536	643	47	121	3	369
1974	869	176	534	159	280	86	455
1975	1,184	892	−23	315	595	399	854
1976	1,829	1,050	−18	797	1,392	−20	834
1977	1,301	752	−159	708	2,100	−81	753
1978	2,625	1,102	758	765	2,865	55	808
1979	2,658	1,497	470	691	3,556	200	1,008
1980	3,900	1,904	1,301	695	4,251	55	1,063
1981	3,641	2,061	−577	2,157	6,408	545	1,608
1982	3,784	3,200	−952	1,536	7,944	528	2,136
1983	139	2,750	−1,137	−1,474	6,470	428	2,564
1984	602	1,116	15	−529	5,941	−144	2,420
1985	834	77	49	708	6,649	−638	1,782

Source: Dohner (1987), table 1.

[a]Increase in central bank reserves and banking system foreign assets, less net inflow of foreign direct investment.

through 1982.[10] What is interesting about all of the measures is that capital flight accelerated in the early 1980s, well before the Aquino assassination in 1983. In fact, the measures in table 6.8 and trade invoice comparisons indicate that capital flight diminished in 1983.

The exodus of capital from the Philippines occurred for a variety of reasons. Political uncertainty heightened in the early 1980s due to the increased strength of the communist New People's Army and questions about Marcos' health and presidential succession. The increasing business influence of Marcos and his cronies and their aggressive actions to take over successful domestic enterprises led businessmen to transfer funds out of the country. In addition, there were the more conventional economic motivations for capital flight—a desire to earn higher real returns on financial investment, anticipate devaluation, or avoid domestic taxation.[11]

In table 6.9 we compare capital flight in the Philippines to that of other LDC debtors. Although capital flight was not the driving force in the Philippines that it was in Argentina and Venezuela, it did play an important role during the period of debt accumulation, accounting for about one-third of the total debt buildup. And the acceleration of capital flight in the early 1980s was part of what swept the Philippines into crisis.

The final factor contributing to the sharp rise in the Philippine debt service burden was a surge in short-term borrowing in the late 1970s and early 1980s. During this period short-term debt grew from 15 to over 25 percent of nonmonetary debt. These loans were contracted at high interest rates and left the country vulnerable to shifts in external confidence. After declining steadily in importance during the early part of the 1970s, short-term, nonmonetary debt began to rise after 1976 (table 6.10). Most short-term debt was in the form of revolving credits, and open accounts (O/A) and documents against acceptance (D/A) used in trade finance.

Acceleration of the payments schedule by international oil companies after the second oil price shock forced the Philippines to use bank financing for oil imports and was responsible for much of the growth in short-term credit.

Table 6.9 **Capital Flight in Selected LDC Debtors (in billions of U.S. dollars)**

	Capital Flight, 1976–82	Increase in External Debt, 1976–82	Capital Flight as % of Debt Accumulation
Philippines	7.3	19.7	37%
Argentina	25.3	34.1	74
Brazil	12.6	65.9	19
Korea	6.1	28.4	21
Mexico	36.1	67.9	53
Venezuela	20.5	26.3	78

Source: Cumby and Levich (1987), table 1 (using Erbe definition of capital flight).

Table 6.10 **Short-term Nonmonetary Debt by Sector (in millions of U.S. dollars)**

	1970	1972	1973	1974	1975	1976	1978	1979	1980	1981	1982	1983	1984	1985
Revolving credits	305	294	273	324	312	571	1,197	1,618	2,477	3,552	3,919	3,968	4,038	2,925
Private	103	249	254	313	283	424	927	1,130	1,541	1,827	1,824	2,041	2,100	1,978
Public	203	45	19	11	29	147	270	489	936	1,725	2,096	1,926	1,938	948
Short-term fixed	54	26	9	7	126	144	160	195	71	112	74	45	144	142
Total short-term debt	359	320	281	331	438	715	1,357	1,813	2,548	3,664	3,993	4,013	4,182	3,068
Private	151	272	262	320	409	568	1,036	1,254	1,601	1,903	1,897	2,045	2,104	1,981
Public	208	49	19	11	29	147	321	559	947	1,761	2,096	1,968	2,078	1,087
Total nonmonetary debt	2,137	2,210	2,306	2,723	3,403	5,099	8,166	9,814	12,230	14,898	17,471	19,145	20,013	20,358
Private	1,071	1,255	1,303	1,533	1,820	2,380	4,028	4,392	5,455	6,386	7,234	6,976	6,703	6,686
Public	1,067	956	1,003	1,190	1,582	2,719	4,139	5,423	6,775	8,512	10,237	12,169	13,310	13,672
Short-term debt as % of total nonmonetary debt	16.8	14.5	12.2	12.2	12.9	14.0	16.6	18.5	20.8	24.6	22.9	21.0	20.9	15.1
Distribution of short-term debt (%)														
Private	42.1	84.8	93.2	96.6	93.5	79.4	76.3	69.2	62.8	51.9	47.5	51.0	50.3	64.6
Public	57.9	15.2	6.8	3.4	6.5	20.6	23.7	30.8	37.2	48.1	52.5	49.0	49.7	35.4
Short-term debt as % of total sector debt														
Private	14.1	21.6	20.1	20.9	22.5	23.9	25.7	28.6	29.3	29.8	26.2	29.3	31.4	29.6
Public	19.5	5.1	1.9	0.9	1.8	5.4	7.8	10.3	14.0	20.7	20.5	16.2	15.6	8.0

Source: Central bank, MEDIAD.

However, particularly in 1981 and 1982, the growth of revolving credit was not trade related but was used to replace maturing long-term credits, particularly by public sector enterprises. Oil import financing was also used to provide credit for other purposes. By 1982 outstanding oil import credits had risen to 85 percent of annual oil imports, although the financing period of the transactions was less than six months. Both PNOC and the central bank were involved in oil import financing on a partly overlapping basis.

Although both private and public short-term borrowings increased, the growth of short-term debt was concentrated in the public sector. Between 1980 and 1982, two-thirds of the increase in short-term debt came from public sector borrowings. As a result the public sector, which had accounted for as little as 3 percent of total short-term indebtedness, accounted for over half in 1982.

The vulnerability entailed in relying on short-term debt became clear in 1983. As anxieties about the Philippines built up during late 1982 and 1983, foreign banks began to reduce their exposure to the country. Between the end of 1982 and the end of 1983, short-term nonmonetary debt outstanding to the Philippines fell by 9 percent (table 6.1), forcing a rapid exhaustion of the nation's reserves.[12]

6.3 Banking System Liabilities and International Reserves

As explained above, short-term debt of the banking system was not included within the external debt monitoring and approval process of MEDIAD and the central bank. Banks were generally encouraged to borrow in foreign currency through the Foreign Currency Deposit System and through the swap facilities that the central bank provided. Over the last half of the 1970s, commercial bank external liabilities grew steadily from $1 billion in 1975 to $3.7 billion in 1980 (table 6.11). The commercial banks were continually net borrowers, but during the 1970s the central bank maintained foreign currency assets large enough to give the banking system a net asset position of about 3 percent of GNP. Foreign currency reserves of the central bank were maintained at a level of about four months' worth of imports.

In order to finance a widening payments balance in the 1980s, the central bank reduced its reserve holdings. It also incurred additional foreign currency liabilities by borrowing from the banking sector and by swapping pesos for foreign exchange. As a result the banking sector, which had shown a net asset position up to 1980, registered increasing net liabilities, reaching 7 percent of GNP and 16 percent of nonmonetary debt by 1982. Capital flight accelerated during the last part of 1982, leading to a precipitous decline in central bank reserves. By September 1983 total reserves were below $700 million, or less than 4 percent of annual imports (table 6.12).

Table 6.11 **Gross and Net Foreign Liabilities of the Banking Sector (in millions of U.S. dollars)**

	Gross Liabilities			Assets			Net Liabilities		
Year	Central Bank	Commercial Banks	Total	Central Bank	Commercial Banks	Total	Central Bank	Commercial Banks	Total
1975	527	990	1.517	1,361	719	2,079	−834	272	−562
1976	566	1,082	1.648	1,642	564	2,205	−1.076	518	−558
1977	39	1,419	1.458	1,525	738	2,264	−1,486	680	−806
1978	152	2,353	2.505	1.883	1,312	3,194	−1,731	1,041	−690
1979	474	2,979	3,453	2,423	1.309	3,732	−1.949	1.670	−279
1980	1,247	3,687	4.934	3.155	1,904	5,059	−1.908	1.783	−125
1981	1.493	4,410	5,903	2.574	2,297	4,871	−1,081	2.113	1,032
1982	2.206	4,870	7.076	1,711	2,540	4,251	495	2.330	2.825
1983	2.690	4,526	7,216	865	1,655	2,520	1.825	2.871	4,696
1984	2,696	4,277	6,973	886	1,837	2,723	1,810	2,440	4,250
1985	2,897	3,338	6,235	1,061	1,915	2,976	1,836	1,423	3,259
1986	3,373	3,089	6,462	2,459	1,986	4,445	914	1,103	2,017
1987	2,685	3,491	6.176	1,959	2,464	4,423	726	1,027	1.753

Source: IMF, *Recent Economic Developments:* 1985, table 14, and 1988, p. 46, table 11.

The deteriorating reserve position of the central bank was not known at the time, for published reserve figures substantially overstated the true reserves of the central bank. In transactions involving the PNOC and the London branch of PNB, the central bank lent and reborrowed existing reserves, counting them twice in reserve statistics. The published reserve figures of the central bank and the later, audited figures are shown in table 6.12. The reserve overstatement varied from month to month, but averaged about $600 million. The existence of the overstatement was discovered in December 1983, after the declaration of a moratorium on principal repayments by the Philippines, and led to the resignation of the central bank governor and an audit of the central bank's books.

The central bank negotiated its last consortium loan in March 1983 for $300 million. The terms of this loan were more severe than the previous consortium loan in 1982, and a substantial portion of the loan was tied to the U.S prime rate instead of the London interbank offer rate for dollar deposits (LIBOR). At the same time in early 1983 the Philippines was borrowing frantically short term, almost at whatever spreads were quoted, despite seemingly substantial reserves, and many banks, sensing that something was wrong, cut back their short-term exposure to the country. The Aquino assassination on August 15 created a rush of anxiety about the country, and when the Philippines declared a moratorium in October, reserves were practically exhausted.

The initial impression among commercial banks after the moratorium was that the rescheduling process for the Philippines would be the easiest to date and achieved very quickly. The announcement of the reserves overstatement

Table 6.12 **Central Bank Reserves (in millions of U.S. dollars)**

	As Originally Stated	(Month's Imports)[a]	After Audit	(Month's Imports)[a]
1980				
December	3,155	4.7		
1981				
March	2,865	3.3		
June	2,597	3.0		
September	2,549	3.0		
December	2,574	3.0	2,574	3.0
1982				
March	2,499	2.7	2,139	2.3
June	2,585	2.8	2,105	2.3
September	2,449	2.6	2,101	2.3
December	2,543	2.7	1,711	1.8
1983				
March	2,433	2.5	1,368	1.4
June	2,282	2.3	1,134	1.2
September	1,431	1.5	682	0.7
December			865	0.9
1984				
March			869	0.9
June			632	0.7
September			471	0.5
December			886	0.9
1985				
March			588	0.7
June			1,037	1.3
September			1,436	1.8
December			1,061	1.3
1986				
March			1,244	1.8
June			1,602	2.3
September			1,710	2.5
December			2,459	3.6
1987				
March			2,484	3.7
June			2,360	3.5
September			2,112	3.1
December			1,959	2.9

Source: Central bank, *Annual Report*, and *Philippine Financial Statistics*.

[a]Defined using total goods and services imports from the previous year.

shattered this optimism and poisoned and atmosphere between the Philippines and the banks and the Fund. External confidence in the Philippines had largely been confidence in the technocrats, and with the discovery of the reserves overstatement this trust vanished. The negotiation process was lengthened greatly by the audit of central bank accounts that the creditors required and by the verification that followed almost every Philippine presentation of information.[13]

6.4 The Debt Management System

During the 1970s and 1980s the Philippines had in place one of the best debt management and information systems among LDC borrowers. Data collected by MEDIAD provided a reasonably complete view of external indebtedness, although it was somewhat weak on short-term borrowings, particularly those of the banking sector. The foreign loan approval system gave the government the tools to control the level of outstanding debt and to influence terms and maturities. The remaining area of debt management is what might be termed macro coordination, information on the demand for additional foreign capital implicit in domestic budget and investment decisions, and decisions about what amount of additional foreign finance was prudent for the country. A presidential directive in 1978 established the Investment Coordinating Committee (ICC), headed by the minister of finance and including the central bank governor, the minister of planning (NEDA), the minister of the budget, and the head of the BOI. Project proposals of over P. 300 million were examined by a subcommittee of the ICC, and a second subcommittee prepared a foreign resources budget for the country.[14]

The debt management system of the Philippines was successful in the 1970s in limiting access to the external loans market and in lengthening maturities, reducing interest rates, and refinancing existing foreign loans. However, the system was not successful in preventing the sharp deterioration of the Philippine debt position in the early 1980s. In particular, it was unable to prevent a very rapid accumulation of short-term debt that raised the debt servicing burden and left the country vulnerable to shifts in domestic and external confidence.

While the Philippines had all the elements of successful debt management in place, there were weaknesses in the operation of the system. The information gathering of MEDIAD concentrated on medium- and long-term debt. The monitoring of short-term debt was less complete, particularly for trade credits, and MEDIAD did not have responsibility for short-term debt of the banking sector. Short-term foreign loans to entities outside the banking sector required central bank approval, but approval was given to public sector corporations to borrow up to certain ceilings rather than approval on individual loans.[15] In the early 1980s the central bank was unable to enforce those ceilings, leading to several directives and a presidential letter of instruction strengthening controls on short-term borrowing in 1983.

While the institutions for macro coordination existed, they were not effective. The ICC failed to adequately screen and rank proposals to borrow; ICC approvals greatly exceeded ceilings on available foreign borrowing. In addition, the discretionary authority that existed under martial law undermined the review and control process. Presidential letters of instruction could supercede the review process and grant foreign borrowing approval, and in the later years of martial law there was a greater tendency to preempt the existing review and regulatory mechanism, not just in foreign borrowing, but throughout the economic policy process.

Nor was external conditionality effective in limiting the growth of external debt. Ceilings on external borrowing were a part of every IMF program that the Philippines undertook, beginning with the extended facility in 1976. In 1982, the one year in which the Philippines did not have an IMF program, the Philippine authorities set reduced limits on external borrowings, and in 1983 set limits that were lower than those contained in the IMF program. In each case the ceilings contained in the IMF program or set by the Philippine authorities were met. However, the ceilings applied only to loans of one- to twelve-year maturities (with subceilings for one to five years) and not to short-term loans.

The second factor favoring short-term borrowing was the debt service ratio contained in Philippine statutes. It is difficult to determine to what extent the Philippine authorities or their external creditors were misled by the stability of the statutory debt service ratio, but there is no question that it influenced the behavior of Philippine policymakers as the ratio approached its ceiling in the early 1980s. What the statutory ratio did not include was short-term revolving credit, which was the overwhelming part of short-term nonmonetary debt. Revolving credit outstanding increased sharply during the 1980s, particularly to public sector enterprises. In addition, the ratio of revolving credit outstanding to trade flows being financed increased sharply, indicating that these credits were being used for general financial purposes and not simply for trade finance.

What comes out of this review is that the character of the debt management and control process, coupled with the willingness of the Philippines to sidestep, but not violate, its limits, greatly weakened the debt position of the Philippines, making the country more vulnerable to external shocks and shifts of confidence.

The Philippines in this period also illustrates a more widespread tendency not to make hard policy decisions until those decisions are effectively forced by events. Philippine policymakers considered declaring a moratorium in late 1982, but then balked after the announcement of the Mexican debt situation.[16] Bankers from some of the major foreign banks in Manila approached the government early in 1983, advising that the Philippines declare a moratorium and ask for a rescheduling of its external debts, but the country instead decided to try to ride out its difficulties.[17] In addition to its international reserve, the central bank had a standby line of credit, arranged in the 1970s, of $450 million that it could have used, but never did. When the moratorium was finally declared on 17 October 1983, foreign exchange reserves were extremely low, and as a result the foreign exchange allocation process that followed was extremely severe.