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In contrast, much of Philippine policy, and certainly much of Philippine nationalism, has been defensive in character, designed to insulate and protect the economy from the outside world and the dangers perceived there. What the Philippines needs to develop is a more aggressive and self-confident nationalism, one that manipulates and takes advantage of the opportunities that the outside world offers—an "inward culture and an outward economy" rather than the reverse (Intal 1987).

In fact, the situation in which the Philippines finds itself today is not so different from the situation characterizing many of the industrializing East Asian countries before their rapid growth took place, although none had the foreign indebtedness that the Philippines now shoulders. Japan, Hong Kong, and Singapore each had to deal with an unfavorable economic event that drastically limited their options and forced them to focus on export growth. For Taiwan and Korea it was the imminent reduction in U.S. aid which had supported domestic investment and large current account deficits that forced the shift in policies.

This is not to say that adversity always leads to success, or that the problems that the Philippines now faces are no more difficult than those faced by the East Asian exporters. Nor will Philippine prospects be unaffected by events and policies in the outside world. External markets that stay open to LDC exports, rather than markets that close down at the first sign of exporting success, will have a tremendous influence over whether economic policy in those less developed countries encourages production at world prices for world markets. A commercial bank lending process that recognizes and rewards successful policy reform and economic growth, rather than a concerted lending process that provides the minimum in financing that a country can get by with, will also greatly influence the incentives for persevering in reform. But whether the Philippines will ultimately be successful will be primarily determined by the actions that the country takes and the commitment that it can forge to policies that achieve growth.

Notes

Chapter 1

1. The tensions created by this migration are the primary force behind the Moslem insurgency which has troubled the Philippines for the past two decades.
2. Golay (1961, 202), Table 39.
3. On the problems of collection of Philippine taxes, see Golay (1961, 186–91). Tait, Gratz, and Eichengreen (1979) provide a comparison to other countries, and rank the Philippines near the bottom in tax effort.

4. U.S. direct investment in the Philippines increased from $149 million in 1950 to $415 million by the end of 1961. U.S. direct investment in manufacturing increased ninefold to account for half of the total by 1961 (Golay 1983, 140).

5. Golay (1983) has compiled a list of sixteen major assets sales to Filipinos between 1962 and 1972 totalling $246 million (152–53, table 6). The source for the table is a memorandum written by the American Chamber of Commerce in the Philippines.

6. Speech before the Rotary Club of Manila, 8 January 1970, as reported in *Central Bank News Digest,* 10 February 1970, p. 6. Quoted in Baldwin (1975, 76).

7. The explanation of the real wage decline and its reconciliation with the national accounts data has become a lively topic for research and discussion. Various sources of wage data exist, and while the year-to-year movements are not always consistent, they all show a substantial decline during the early 1970s. Lal (1983) has argued that the real wage decline can be explained by a fall in the price of (labor-intensive) nontradables relative to (capital-intensive) traditional exports. The reconciliation issue is addressed somewhat inconclusively by Oshima, de Borja, and Paz (1986). They found that between 1970 and 1980 real wages fell by about 10 percent and, at the same time, national income per person employed rose by about 25 percent. They argue against an increase in hours per person employed as an explanation for the income growth. Nor does there appear to be evidence of a substantial shift in income shares. One possibility that they raise is that the growth of national income may have been substantially overstated, "perhaps even by one-half" (10).

8. Average ODA receipts for 1969–71 were $79 million per year. From 1972 to 1975 they averaged $181 million (OECD, *Geographical Distribution of Financial Flows to Developing Countries,* various issues). U.S. military assistance to the Philippines also doubled during the period, from $60 million in fiscal years 1970–72 to $119 million during fiscal years 1973–75 (Abueva 1979, 39).

9. The Marcos land reform was limited in scope and has been widely criticized. However, it went further and was more successful than any previous land reform. It also had high public visibility. Land reform was limited to corn and rice land, and did not include sugar and coconut lands.

10. Marcos took Manila Electric Company from the Lopez family, as well as their holdings of television stations. From the Jacinto family he seized a steel complex which became the National Steel Company. Among the initial arrests under martial law was Eugenio Lopez, Jr. The story circulated in the Philippines was that the senior Lopez was told that to see his son again he would have to sign over his fortune to a specially created organization, the Marcos Foundation (Race 1975, 5).

11. The sharp rise in the price of coconut products in 1974 was associated with the particularly large reductions in Philippine exports that year due to bad weather. The price of copra rose by 140 percent between 1973 and 1974, a period in which world exports of copra fell from 1.05 million metric tons to .53 million metric tons. Philippine exports fell from .73 to .29 million metric tons in the same period. Due to the Philippine's large share in the world coconut market, Filipinos occasionally talk of monopoly power in coconuts. This one-year example lends some support. Even so, the value of Philippine copra exports fell by 16 percent in 1974, suggesting that it is not a very profitable monopoly. Data from UNCTAD, *Yearbook of Commodity Trade Statistics,* 1979.

12. There is no single measure for the income effect of the terms of trade shock. The measure that we prefer focusses on the additional domestic resources necessary to maintain a given level of imports. Philippine terms of trade in 1976 were 29 percent below their 1970–72 average. The average import share of GNP in 1970–72 was 19.2 percent. (.29)(.192) = .0557.

13. Since the Philippines was engaged in a conflict with Moslem secessionists in Mindanao, supplies of oil to the country were to be reduced by 25 percent under the terms of the OPEC embargo. In 1974 Marcos declared a target of reducing oil imports from 90 percent of energy supply to 70 percent in five years' time.

14. Interview with Gerardo Sicat, former Director-General, National Economic and Development Authority, Washington, D.C., June 1986.

15. Over the same period the rates of export volume growth for other countries in the region were: Korea, 16.4 percent; Malaysia, 10.2 percent; Singapore, 16.6 percent; and Thailand, 17.0 percent.

16. In contrast to other countries in this study, exports of services make up a significant part (one-third) of total Philippine exports. These include the rental on U.S. military bases, but also the supply of overseas workers and construction services. Dollar earnings from exports of goods and services stayed roughly constant from 1980 to 1984.

17. In a swap arrangement a bank would borrow abroad in foreign currency and then exchange the proceeds with the central bank for pesos. The central bank in turn agreed to sell foreign currency to the bank at a set exchange rate in the future, so the bank could pay back the loan.

18. The year 1978 was taken as the starting point for the terms of trade calculation. Between 1978 and 1982 import prices rose 33.1 percent relative to Philippine export prices. This multipled times the 1979 import share of GNP of 20.8 percent equals 6.89 percent. The average interest rate paid on Philippine external debt rose from 5.21 percent in 1979 to 8.73 percent in 1982. Rates of export price inflation used to calculate the real interest rate were 5.20 percent (1975–79 average) and −2.96 percent (1979–85 average). The change in the real interest rate was multiplied times the share of gross external debt, less foreign assets of the monetary system, in average 1979–80 GNP. These types of calculations are highly sensitive to the endpoints. The endpoints were chosen as reasonable approximations and produce neither the highest nor the lowest income changes possible.

19. The ratio described is the increment in the capital stock (investment) divided by the increment in GDP. Divide numerator and denominator by the level of GDP to get the share of investment in GDP divided by the growth rate of GDP, the conventional ICOR measurement. The ICOR is an ex post and far from perfect measure of the efficiency of investment. There are questions of the timing of returns to investment, net versus gross additions to the capital stock, and short-run fluctuations in output. Thus ICOR measurements are sensitive to the time periods over which they are constructed, and are more useful when measured over longer periods. Furthermore, ICORs neglect other inputs, and therefore do not really measure the profitability of investment. However, despite these difficulties, ICORs represent a rough, but useful, measure of the effectiveness of countries in generating growth from their investible resources, and that approach is used here.

20. The rise in energy prices after 1973 made investments to reduce oil consumption profitable, even if they did not add to domestic final goods output, and

also made investments in (generally capital-intensive) domestic energy production profitable.

Chapter 2

1. In addition, before 1976, the Philippine fiscal year ran from July to June. In 1976, the fiscal year was shifted to January to December.

2. The rise in defense expenditures is somewhat misleading since many of the local police forces were absorbed within the military, and the share of justice and police in the budget falls accordingly. The military did increase its power and influence, as well as its size, during this period, but the budget figures overstate the increase in defense as a budget activity.

3. There was also a transfer of P. 1,300, about 11 percent of current expenditures, made to the Philippine Coconut Authority, which purchased First United Bank (renamed the United Coconut Planters Bank) in that year. Domestic prices for coconut products were subsidized with a producers levy.

4. Average ODA receipts for 1969–71 were $79 million per year. From 1972 to 1975 they averaged $181 million (OECD, *Geographical Distribution of Financial Flows to Developing Countries*, various issues). Data on development loans is from Magno (1976), table 6. The formation of the Consultative Committee for the Philippines in 1970 was also instrumental in focussing attention and organizing resources for the Philippines.

5. These transfers were P. 640 million in 1975 and P. 1.9 billion in 1976. Equity and net lending to government corporations again grew substantially at the end of the decade. See the line on equity contributions in table 2.2.

6. Half of the capacity addition came through new plant construction; the remaining half came from the purchase of existing oil-fired power plants from the privately owned Manila Electric Company.

7. The details of the Marcos decision and Disini's role in it are the subject of much controversy. Jesus Vergara, the former head of Westinghouse's Philippine sales affiliate, told investigators from the Aquino government that Westinghouse paid Disini a commission of at least $50 million, and that Disini gave Marcos about $30 million of that. Westinghouse denies that money went to Marcos, but admits giving a commission of $17 million to Disini. A U.S. Justice Department and Securities and Exchange Commission probe was launched after the contract was signed, but a grand jury in 1978 voted not to indict Westinghouse under the Foreign Corrupt Practices Act. The SEC's enforcement division was reportedly considering in mid-1986 whether to start a new probe of the Westinghouse contract. See Dumaine (1986).

8. The nuclear power plant has figured prominently in Philippine proposals for "selective repudiation" of its foreign debt, and the Aquino government has recently filed a suit against Westinghouse over the plant.

9. Cash generation by public enterprises was relatively small, but the two government social security institutions provided savings of about 1 percent to GNP. See table 2.16.

10. For a discussion of the NPC proposal, see World Bank (1982), vol. 1, pp. 48–50.

11. For a discussion see Oshima (1983).

12. Presidential Commission on Government Reorganization (1985b), annex tables A, A.1.

13. Ibid. Table 7, p. 15.

14. This is borne out in several comparative tax effort studies, referred to by Manasan (1982, 261–62). Tait, Gratz, and Eichengreen (1979) rank the Philippines 41st out of 47 countries in their sample in terms of tax collection from existing tax bases.

15. See Golay (1961), chap. 9 for a discussion of Congress and tax policy.

16. See Kintanar (1976) for a discussion of the tax reforms in the early years of martial law.

17. The tax amnesty and early martial law period did add a large number of persons to the taxable rolls, explaining part of the secular rise in individual income tax collections.

18. In 1977 the benefits of BOI registered firms under the Investment Incentives Act were estimated at P. 926.8 million (a little over 5 percent of total tax collections). Of this, about half represented deductions from taxable income and the rest exemption from indirect taxes (World Bank 1980, tables 2.6, 2.7).

19. IMF (1985b, 81), table 33.

20. Buoyancy and elasticity are two measures of the responsiveness of tax collections to income changes. Elasticity measures the response of the existing tax structure to changes of income. Buoyancy is a measure of the ex post change in tax collections with a change in income, including the effects of any changes in rules or rates.

21. Taxpayers with over P. 1 million in income accounted for 23 percent of taxable individual income and 61 percent of tax collected in 1978. See Diokno (1986), table 2.

22. IMF (1985b, 31), table 13. The estimation procedure used only urban household income, and is described in pages 26–30 of that study.

23. IMF (1985b, 85), table 35. Two presidential decrees in 1984 eliminated most tariff and tax exemptions, but in the next few months a large number of the previous exemptions were reinstated.

24. An article in *Business Day,* "Coconut Fund Nearing P. 6 billion," 1 September 1980, gave a figure of P. 5.8 billion at that time.

25. Presidential Commission on Government Reorganization (1985a, 65). Mrs. Marcos, who was minister for human settlements, was also known for soliciting "donations" from corporations and institutions to support the various projects that she undertook.

26. Manuel Montes and Emmanuel de Dios make this argument. See Montes (1986, 45–49) and de Dios and Montes (1985).

27. BIR employees repeatedly made this point to the IMF mission. See IMF (1985b, 100, 103–4).

28. This count, and in general the statistics available for government-owned corporations, excludes private companies that were acquired by the state due to bankruptcy or default and therefore differs from the privatization list.

29. The most important battles were the attempts of the finance minister, Cesar Virata, to remove the coconut levy and circumscribe the trading monopoly of the National Sugar Trading Corporation (NASUTRA) in 1981. Marcos suspended the levy in 1981, but reinstated it after pressure from Eduardo Cojuangco. The Philippine cabinet overruled the proposal on NASUTRA in September 1981. See "Philippine Technocrats Lose Round in Fight to Depoliticize the Economy," *Wall Street Journal,* 29 October 1981, p. 34.

30. See IMF (1985b, 85), table 35, and the discussion (84–86).

31. See Amatong et al. (1985), who state "the study concludes that [national government] contributions expand rather than reduce the need for borrowing" (54).

32. Lamberte (1984), tables 1, 8.

33. Since most of the forward contracts were drawn with public corporations, the losses were in a sense transferred from one public sector agency to another. However, the existence of the contracts may have meant a greater exchange rate exposure of the public sector, and thus greater losses, than it would have suffered had the operations of corporations like PNOC been uncovered.

Chapter 3

1. The major references on Philippine trade policy are Power and Sicat (1971), Baldwin (1975), Bautista, Power, et al. (1979), Bautista (1981), Alburo and Shepherd (1986), and Power and Medalla (1986).
2. See, for instance, Sachs (1985).
3. Hooley (1985, 24, 26), tables 6, 7. Industry output data show large year-to-year variations in the Philippines, apparently due to differences in the degree of reporting, so conclusions about productivity in the Philippines must be somewhat tentative.
4. Baldwin (1975, 10), table 1–4.
5. See Alburo and Shepherd (1986), especially pp. 96–98.
6. Power and Sicat (1971, 43) and Alburo and Shepherd (1986, 91).
7. George L. Hicks, "Philippine Foreign Trade, 1950–1965: Basic Data and Major Characteristics" and "Supplementary Data and Interpretations, 1954–1966," (National Planning Association, Center for Development Planning, Washington, D.C., 1967; mimeo), cited in Baldwin (1975, 64), fn. 18.
8. The product groups for which imports were regulated specifically for industry protection included textile fabrics, synthetic yarns, fibers and threads, basic iron and steel products, newsprint, used and new tires, synthetic resins, liquid caustic soda, cellophane and paper and paperboard products.
9. See de Dios (1986).
10. This policy was enforced through the Board of Investment's control over imports of capital goods.
11. Gregorio (1979, 217) and summary by Bautista, Power, et al. (1979, 33).
12. Interview with Cesar Virata, Washington, D.C., November 1986.
13. World Bank (1986), vol. 2, p. 145.
14. World Bank (1987), vol. 2, pp. 94, 98, and table 3.11.
15. Power and Medalla (1986, 24), table 3.
16. In addition, the Philippines did not have speculative capital inflows, such as occurred in Chile.
17. See chapter 1, n. 7.
18. See Clunies-Ross (1966) and Bautista (1976) for analyses of Philippine inflation, and the review by Tan (1980, 226–35). Food and beverages accounted for 60 percent of the consumer price index in the Philippines as late as 1978.
19. World Bank (1987), vol. 1, p. 17.
20. World Bank (1980, 55), table 2.9.
21. Alburo and Shepherd (1986, 107), table 3.1.
22. American Apparel Manufacturers Association, "Apparel Manufacturing Strategies, 1984," quoted in World Bank (1986), vol. 2, p. 160, table 5.10.
23. This overstates the actual decline in log exports, since undeclared and illegal exports of logs increased substantially during the 1970s.

24. During the international commodities boom in the early 1970s, the Philippines introduced premium taxes of 20–30 percent on the excess of commodity prices over their February 1974 level. These collections disappeared when international prices fell below the base level.

25. Hooley (1985, 26), table 7.

26. Much of this was in energy and mining, as well as manufacturing

Chapter 4

1. The Philippine sugar quota to the U.S. market rose from 864,000 metric tons to 1.3 million metric tons in 1961. The Philippines gained additional quota amounts when other producers failed to meet their additional quotas.

2. See Brown (1986).

3. Benedicto was also regional director of Marcos' political party, the New Society Movement, and had been ambassador to Japan in the late 1960s and early 1970s, when the Philippines contracted with Japanese firms to construct several new sugar mills.

4. Canlas et al. (1984, 81), table 13. The revenue estimates are after subtraction of a 10 percent allowance for trading costs.

5. "End of An Experiment," *Far Eastern Economic Review,* 16 October 1981, p. 125.

6. David, Barker, and Palacpac (1984) show a decline in yield per hectare of 4.3 percent per year during the 1960s, and a gain of 0.8 percent per year during the 1970s.

7. *Philippine Statistical Yearbook* 1987, p. 270, table 5.1.

8. During 1970–82, the number of nuts per bearing tree averaged 39 per year as against 42 nuts per year during the 1960s (NEDA 1985, table 1.13).

9. The share of coconut oil relative to the sum total of world production of soybean oil, palm oil, and coconut oil declined from about one-quarter in 1968 to about one-eighth in 1983; in contrast, the share of palm oil rose from about one- sixth in 1968 to about one-quarter in 1983 (Ibid., table 3.10).

10. Canlas et al. (1984), appendix 1, lists 688 presidential decrees and 283 letters of instruction that involved government intervention in the economy.

11. See for instance, Sicat (1986, 28–29, 36–38).

12. See Coronel (1986, 3).

13. See Espinosa (1986) for a discussion of the BASECO case.

14. See, for instance, Mijares (1976, 197–202).

15. There are various sources on the distribution of crony assets. See, for instance, Doherty (1982), Canoy (1980), and the *Manila Times,* 16 May 1986. Extensive, but controversial, information may become available if the investigations of the Presidential Commission on Good Government are ever made public.

16. See Villegas (1986, 163–64). Imelda Marcos was once asked why so many relatives and associates of the Marcos government had profited so greatly during the martial law years. She replied, in a famous quotation, "some are smarter than others." This became the title of an underground analysis of cronyism in the Philippines that was ultimately published as Doherty (1982).

17. This is not to say that there was no competition among the cronies. Although instances are hard to come by, there was an attempt by Eduardo Cojuangco to take over the monopoly trading in sugar—the province of Roberto Benedicto—in the

1980s when NASUTRA had financial difficulties. But the competition was generally over exclusive rights in an industry, rather than between or among firms in an industry.

18. Although, even without competition, several of the cronies went bankrupt in the early 1980s.

19. As Benjamin Diokno, an academic and now an official in the Budget Ministry, put it, "In advanced countries, the government intervenes when firms are in distress. We did some of that, but [the Marcos government] tended to intervene when firms were profitable" (Interview, Manila, 25 August 1986). The government gained control of the export of labor services when that industry grew in size in the early 1980s, and had plans, before the 1986 election, to intervene in the videocassette rental industry.

20. Interview with Fred Whiting, President, Sime Darby, Philippines, Manila, 8 December 1986. Sime Darby had been worried about Cojuangco during the last years of the martial law government, but found, after Corazon Aquino came to power, that Marcos' son-in-law, Freddy Araneta, had intended a takeover of part of Sime Darby's operations.

21. In order to provide a scale against which these amounts may be measured, one billion pesos in 1981 was roughly one-third of 1 percent of GNP, and just under 1 percent of gross domestic credit of the banking system.

22. *Business Day* (Manila), 24 February 1983. Cited in Ibon (1983a, 7).

23. Ibon (1983a), based on news reports.

24. Lamberte (1984), annex A.

25. Lamberte (1984, tables 4 and 6.

26. The most publicly outspoken critic was Jaime Ongpin, brother of the director of the National Development Corporation and, until October 1987, finance minister in the Aquino government, who termed these actions "the most disgraceful waste of public funds since independence." See his "A Matter of Decree" and "A Matter of Principle" (Manila; mimeo, ca. March 1983).

Chapter 5

1. More general and complete descriptions of the Philippine financial system are found in World Bank and IMF (1980) and Pascual (1984).

2. Asian Development Bank (1985, 37), table 4.1. For comparison, the figure for Thailand was 4.5 percent, Korea, 5.4 percent, and Indonesia, 0.1 percent.

3. PNB Bank is now a much smaller bank, since its nonperforming assets have been transferred to the Asset Privatization Trust (APT) as a part of the restructuring of government financial institutions carried out by the Aquino government. The current intention of the government is to ultimately convert PNB into a privately owned commercial bank.

4. Lamberte et al. (1985, 30), table 3.8.

5. As was the case with PNB, the transfer of DBP's nonperforming assets (almost 90 percent of its loan portfolio by 1987) to the APT has left it a much smaller institution.

6. These guarantees were not carried on the balance sheet of the institution.

7. The financial crisis which occurred in the money market in 1981 and the continuing difficulties of financial institutions in that market led to a greatly reduced

role for deposit substitutes, which accounted for only 6 percent of total liquidity by 1985.

8. The fact that the lending by foreign currency deposit units was almost entirely to domestic residents was not known by the Philippine's external creditors. Thus, the net external debt of the monetary sector was almost equal to its gross debt, and much higher than external creditors thought. This was the surprise that was contained in the Philippine announcement that the country's external debt, including monetary debt, was over $25 billion, instead of the published $19 billion figure that included only nonmonetary debt.

9. In 1971–72, when ceilings limited commercial bank loan rates to 12–14 percent, studies by the National Economic Council (NEDA's forerunner) and Victor Barrios show a range of 14–29 percent (Tan 1980, 205). The World Bank and IMF (1980) study reported effective rates in the money market of up to 30 percent.

10. Average for 1971–73.

11. Precise ownership and control patterns are difficult to establish. Estimates range from two-thirds (World Bank and IMF 1980, 8) to 23 out of 28 banks existing in 1980 (Doherty 1980, chap. 5), quoted in Patrick and Moreno (1985, 316).

12. Gregorio Licaros, then central bank governor, quoted in the *Far Eastern Economic Review*, 7 April 1978, p. 80.

13. The acquired banks were Associated Bank (acquired by DBP), Commercial Bank of Manila (GSIS), International Corporate Bank (NDS), and Union Bank (SSS and Land Bank). The government owned two additional banks, Republic Planters Bank, acquired in 1978, and Pilipinas Bank, acquired by PNB in 1980.

14. For a discussion of the "political banks," see Patrick and Moreno (1985) and Canlas et al. (1984, 65–72).

15. In fact this understates the influence of the government in the financial system. As one Philippine banker put it, "Look, everyone made behest loans. You would receive a phone call asking you to make a loan. If you refused you would have labor problems, or the Metro-Manila government would close you down on a health or safety violation." (anonymous interview in Manila, 19 December 1986).

16. Robert Emery, writing of the 1960s, commented, "the Philippines has probably had more financial scandals, or financial institutions in distress, than any other Southeast Asian country" (1970, 482).

17. LIBOR ranged from 6 to 12 during 1974–79. A study by the Ministry of Industry in the Philippines (cited in the World Bank and IMF 1980 study) also found foreign borrowing significantly less expensive than domestic borrowing for Philippine firms.

18. From Business Day, *Top 1000 Corporations in the Philippines*, cited in Lamberte (1985), table 3.10.

19. Dee reportedly suffered huge losses in commodity speculation. He later surfaced in Canada, where he applied for asylum.

20. *Asian Finance*, 15 September 1981, p. 88.

21. The vast majority of central bank advances went to two institutions. Atrium Capital, a member of the Herdis (Disini) group, received over P. 1 billion, while Bancom, an institution that had founded the deposit substitute market, received P. 400 million.

22. Technically the commercial paper of these firms had been sold to the public without recourse to the financial institution, in large part to evade the regulation of the central bank. In fact, the instruments were in many cases accompanied by the postdated checks of the financial institutions, and many institutions allowed

pretermination of the investments. When the central bank stepped in, the default risk was removed from the public and placed on the institutions or, ultimately, on the central bank.

23. They were Republic Planters Bank (1978), Pilipinas Bank (1980), International Corporate Bank (1981), Union Bank (1981), Associated Bank (1982), and Commercial Bank of Manila (1982).

24. Development Bank of the Philippines, *Annual Report,* 1982.

25. The World Bank reports evidence that the Philippines paid significantly more for capital equipment (World Bank 1986, vol. 2, p. 133). Japanese companies were reported to have cooperated in these schemes, and that has been an alleged reason for the reluctance of the Japanese government to cooperate in the Aquino government's investigations of hidden wealth. See "Kickback for Japan" *Far Eastern Economic Review,* 24 April 1986, pp. 42–43, and "Marcos Papers Show Japanese Sought to Avoid Payments," *Washington Post,* 22 March 1986, p. A1.

26. Aide-mémoire from DBP President Cesar Zalamea to President Aquino, 11 March 1986. Cited in "DBP Bankrupt since Dec. 1983," *Manila Times,* 29 March 1986, p. 1.

27. "DBP Bankrupt Since Dec. 1983," *Manila Times.* DBP president Zalamea is quoted in the aide-mémoire as saying, "at a time when large borrowings were possible from both the domestic and international markets, DBP did not hesitate to draw such funds to cover cash losses and pursue lending programs."

28. "COA Bares Bad GSIS Investments," *Business Day* (Manila), 10 September 1986, p. 15.

29. "Government May Suffer P. 70 billion Loss," *Business Day* (Manila), 8 September 1986, p. 2. The 30 billion peso figure is the difference between booked and total exposure to the nonperforming assets.

30. See Fry (1986) for a summary of the consequences of financial policy in the Philippines that makes many of the points listed here.

31. The importance of interest rate controls, or "financial repression," in reducing savings is controversial. Fry (1978) found a significant effect of real interest rate levels on savings mobilization in a group of Southeast Asian countries that included the Philippines, a finding contradicted by Giovannini (1983). For the Philippines, the periods of substantial growth of financial intermediation, the 1950s and the early 1980s, were periods when interest rate controls were absent or nonbinding. Controls also influenced the form in which savings were mobilized, as savings flowed into deposit substitutes and money market instruments in the 1970s.

Chapter 6

1. The Monetary Board is chaired by the minister of finance, and includes the governor of the central bank and the minister of planning.

2. The inclusion of gross short-term external debt of the banking sector is the reason for the large jump in published figures of Philippine external debt that appears in 1983, from approximately $19 billion to $25 billion.

3. In addition, FCDUs were required to maintain foreign exchange cover equivalent to foreign currency liabilities, and faced limitations on maturities of their lending. The relevant central bank circulars governing FCDUs are 343 (April 1972) and 547 (November 1976). Liabilities of these units are often referred to as 343/547 deposits in Philippine statistics.

4. Central bank, *Annual Report,* vol. 1, various issues.

5. IMF, *World Economic Outlook,* April 1986, p. 243, table A47.

6. Data from MEDIAD.

7. IMF (1984b, 129), table 56.

8. Gross liabilities of the banking sector were an additional $5 billion, or 40 percent of nonmonetary debt. However, in 1980 the Philippine banking system still had a small net asset position.

9. See Cuddington (1986) and Cumby and Levich (1987) for a discussion of measurement concepts for capital flight. This section on capital flight draws on Dohner (1987), where the measures used are derived. Cumby and Levich also present data for the Philippines and reach similar conclusions about the rise in capital flight in the early 1980s, well before the Aquino assassination.

10. Dohner (1987), table 4.

11. Dohner (1987) estimates regressions equations for several measures of Philippine capital flight. The results confirm the importance of domestic and foreign interest rates and the real exchange rate in determining capital flight.

12. Figures on short-term debt collected by MEDIAD and the central bank's Financial Plan Data Center differ, due to the latter's more inclusive definition. Thus the figures in table 6.10 do not show a decline.

13. Other than the reserves overstatement, little else was uncovered about Philippine statistics. The employment, unemployment, and wage data are subject to question, as is the true extent of savings and investment in the Philippine economy. But no additional examples of data falsification arose.

14. The first was the Subcommittee on Major National Projects (SMNP) and the second was the Foreign Resources Subcommittee. The World Bank (1984a), chap. 4, has a good description and evaluation of the debt management system in the Philippines.

15. Export-oriented firms were also given approval to borrow short term for pre-export financing, raw materials, supplies, and spare parts.

16. Interview with Cesar Virata, Washington, D.C., October 1986.

17. Interview with Robert Hess, Chase Manhattan Bank Manila, 25 November 1986.

Chapter 7

1. In most cases export taxes were increased from 4 to 6 percent, but taxes for coconut products were doubled, and taxes were introduced for the first time on coffee and tuna exports.

2. There was an increase in central bank credit to public sector enterprises during the year, but this was a relatively small part of total financing.

3. Reserve money corresponds to the conventional definition of high-powered money—currency in circulation, banks' holdings of cash, and bank reserves with the central bank. In the Philippines certain government securities are also eligible as reserves. A more precise measurement of high-powered money is provided by what the IMF calls "base money"—reserve money, plus reserve-eligible securities, plus banks' reserve deficiencies. It is only recently that longer series for base money have become available, and most policy discussions and program limits were phrased in terms of reserve money.

4. Rates were phrased in terms of so many percentage points below the Manila Reference Rate (MRR). The MRR is the weighted average of the interest rate paid by the ten largest commercial banks on deposit substitutes or promissory notes of ninety day maturity.

5. The thirteen commodities controlled by the Price Stabilization Council included rice, corn grits, chicken, eggs, pork, sugar, milk, canned fish, and some school supplies. Together these commodities made up 24 percent of the Consumer Price Index. Rice alone accounted for 11.6 percent.

6. Price interventions by the government took the form of price ceilings and differential taxes (for petroleum products). For some commodities such as rice, government procurement policies set price floors. However, Philippine price intervention policies did not involve major subsidization by the government. There were producer levies in the sugar and coconut industries that supported consumer prices for sugar and cooking oil below world market levels. In addition, the government would occasionally (generally before elections) import rice and other consumer goods to insure sufficient domestic supply.

7. Reserve money became an additional and more prominent monetary target due to the suspicion cast on net domestic assets by the reserves overstatement, and by disputes on what should be included in domestic assets. Since net domestic assets is a balance sheet counterpart to net international reserves, an overstatement of reserves should also have resulted in an understatement of net domestic assets. The reserve money figure gained prominence because it was more easily and more accurately measured.

8. The crisis started after leaflets were spread across Manila in which it was warned that various banks were unsound, urging people to take their money out.

9. This tax was 30 percent of the difference between the commodity price at the new exchange rate and its price at the previous exchange rate of P. 14 per dollar. At an exchange rate of P. 18 per dollar, this implied an effective exchange rate for the exporter of P. 16.8.

10. In fact adjustments were included to incorporate changes in reserve-eligible securities held by banks and in reserve deficiencies, so that the targeted variable was in fact base money—total high-powered money, or support for deposit expansion.

11. The Philippine letter of intent was published by *Business Day* (Manila), 3, 4, and 5 January 1985.

12. The bank advisory committee was headed by Manufacturer's Hanover, with the Bank of Tokyo as deputy. It included Bank of America, Banque National de Paris, Barclays, Chase Manhattan, Citibank, Morgan Guaranty Trust, and the Bank of Montreal. Later, Dresdner Bank and Fuji Bank were added to the advisory committee.

13. This matched the foreign exchange assets of Citibank's Manila branch that were held outside the Philippines. Thus it did not involve a principal repayment from the Philippines.

14. As in the case of the Citibank deposits, the issues at stake went beyond the Philippines. National Commercial Bank's exposure to the Philippines was dwarfed by its $4 billion lending to Korea. It was concern about a possible standstill and rescheduling in Korea, more than in the Philippines, that apparently motivated the bank's refusal.

15. The Philippine commercial bank restructuring package is described in more detail in Bucheit (1985), Hutton (1985), and Villaruel and Reyes (1985). For information about the FICORCA program, see chapter 8 of Edward Buffie's study of Mexico in volume 2 of the Sachs series on developing country debt.

16. Only the program for restructuring private financial sector debt had a provision for the Philippine government's assumption of private debts. The major dispute over government assumption of private sector debts came in the PPI case, described above.

17. The trade facility was also large because the Philippines had used trade finance to cover part of their balance of payments deficit through the central bank oil facility in the period prior to the moratorium.

18. Watson et al. (1986), table 40.

19. In this section, unless otherwise indicated, we measure the rate of inflation by the change in prices over the previous six months, expressed as an annual rate.

20. Data from IMF (1985c), annex 1. This figure probably underestimates the drop in real wages that took place.

21. This and the following discussion draw on Tidalgo and Esguerra (1984, 75–82).

22. Domestic credit extension of the central bank is defined here as all other net domestic assets of the central bank, ie., net domestic assets plus the (positive) stock of outstanding CB securities.

23. World Bank (1987), vol. 1, pp. 10–11, n. 19. See also Montes (1987, 28–32).

24. The World Bank argues that these raised bank spreads by seven percentage points in 1985 (World Bank 1986, vol. 2, pp. 25–26).

25. Philippines, Ad Hoc Study Group (1986, 23).

26. See "Philippines Reels Under Severe Restraints," *Asian Finance*, 15 September 1986, pp. 118–19. IMF Managing Director Jacques de Larosiere reportedly overruled staff recommendations and insisted on tighter conditions in the 1984–85 program because of the overstatement of reserves (*Far Eastern Economic Review*, 26 July 1984, p. 49).

27. Montes (1987) makes this argument.

Chapter 8

1. See World Bank (1985, 8–19).

2. Business interest groups, such as the Makati Business Club, were established during this period.

3. Cardinal Jaime Sin persuaded the two candidates to unite on a single ticket and Laurel to accept the vice presidential spot.

4. The mass mobilizations of civilians around the rebel army camp gave the government transition its name, the "People's Power Revolution." The story of these events is told in Johnson (1987).

5. Philippines, Department of Budget and Management (1987, 3).

6. Ibid., 14. The P. 24 billion is larger than that of table 2.16 because it includes transfers to the central bank.

7. For further discussion and analysis of the Aquino government's economic performance, see Dohner (1988).

8. Philippines (1986), tables 1, 2. The large increase in the deficit of the national government is deceptive because it included transfers of liabilities from NPC and the government financial institutions.

9. Sanchez was later dropped from the cabinet during a reorganization in late 1986.

10. Arroyo and Ongpin had fought bitterly within the cabinet, and the departure of Ongpin was a condition for Arroyo's resignation. Ongpin was replaced by another businessman, Vicente Jaime, who had been appointed head of the Philippine National Bank by Aquino. Several weeks after he left the cabinet, Ongpin was found dead, the victim of an apparent suicide.

11. Their 1984 report (Canlas et al. 1984) was strikingly critical of government economic policies. On the influence of University of the Philippine economists in the new government, see Rigoberto Tiglao, "UP Economists Gain Influence," *Business Day* (Manila), 19 May 1986.

12. In general orientation, particularly in the emphasis on rural-based development policy, the yellow book proposals closely resemble those of the 1973 International Labour Office study mission headed by Gustav Ranis (ILO 1974).

13. The yellow book did argue for repudiation in cases where loans were made for fraudulent purposes with the knowing participation of the lender.

14. Compare for instance, NEDA's "Policy Agenda for People-Powered Development" (1986).

15. Not all of this is a net improvement in the government's budget position since some of the increased revenues come from the withdrawal of tax exemptions of government corporations, which would be offset, at least in the short term, by increased government contributions to those firms. The estimated yield from removing tax exemptions was P. 4 billion in 1987 (Philippines, Department of Budget and Management 1987, 25).

16. These efforts were supported by funds and technical assistance from the World Bank.

17. Tax exemptions were later reintroduced for NPC, and reforms in power pricing have been very slow.

18. The valuation of nonperforming assets varies by the measure applied; the broadest, which produces the $7 billion figure, includes unbooked interest and penalty charges. Total booked exposure of the nonperforming assets is estimated to be $5.5 billion.

19. As a result of the restructuring, the share of PNB in commercial bank assets was reduced from 28 percent in 1985 to 13 percent in 1987.

20. *Business World* (Manila), 8 December 1987, p. 3.

21. *Far Eastern Economic Review*, 5 November 1987, p. 84.

22. On the Philippine privatization program, see Haggard (1988) and "Manila's Hardy Privateers," *Far Eastern Economic Review*, 7 July 1988, pp. 88–93.

23. World Bank (1987), vol. 1, p. 38, quoting a study done by Rosario Manasan.

24. World Bank (1987), vol. 1, p. iii.

25. See Koppel (1987) for a discussion of the Marcos land reform and land manipulation experience.

26. Citibank was apparently supported in this position by the Bank of Montreal (*Wall Street Journal*, 26 January 1987, p. 24). The Philippines reacted angrily to the intransigence of Citibank in the negotiations, and there were calls in the country at the end of 1986 for a reduction in the operating authority of the Citibank branch in Manila.

27. Under the proposal, PINs applied to the spread only; the base rate (LIBOR) would continue to be paid in cash. The accounting implications of PINs were ambiguous, and may have required that banks write down their holdings of Philippine debt. To date, no PINs have been issued.

28. Interest rate spreads on restructured debt of the private financial sector, where the lender retained the commercial risk, were higher, but could not exceed one and three-eighths percentage points over LIBOR. The repricing of the 1985 new money facility carried additional restrictions. The Philippines agreed to prepay 4 percent ($37 million) of the facility before 1991, and also agreed that if the country missed any of its principal payments, the spread would revert to 1 percent.

29. A peculiarity of the Philippine balance of payments statistics is that U.S. Economic Support Funds, which are an outgrowth of the current agreement on U.S. military bases, are included as service receipts. The Philippine government regards these as the equivalent of rental payments, while the U.S. government considers them aid. These amounted to $62 million in 1985, $300 million in 1986. Even after netting these out, the Philippines had small surpluses on service account in 1985 and 1986.

30. These and other issues surrounding the 1989 debt negotiations are discussed in Dohner (1989).

31. In 1987 the Philippines was forced to import sugar on the world market in order to meet its export quota to the United States, so there is still some prospect of increased net export earnings as the sector recovers.

32. World Bank (1987), vol. 2. p. 266.

33. A study done by the American Apparel Manufacturers Association in 1984, "Apparel Manufacturing Strategies," gives the following productivity-adjusted wage comparisons for the industry: United States, 6.50; Hong Kong, 2.56; Taiwan, 2.33; Korea, 1.67; Jamaica, 1.36; Costa Rica, 1.33; Egypt, 1.10; Philippines, 1.00; Haiti, .80; and China, .75.

34. World Bank (1987), vol. 2, p. 276.

35. World Bank (1987), vol. 2, p. 127.

36. World Bank (1986), vol. 1, p. 25.

37. As Customs Commissioner Salvador Mison told his staff in November 1987, "Don't take bribes. Accept only 'tokens of appreciation'." Quoted in Claudia Rosett, "Aquinos Embattled Democracy," *Wall Street Journal*, 2 March 1988, p. 21.

38. This is similar to the notion, developed by Albert Hirschman, of "trait-taking" technologies that are robust to corruption. He compares truck transport with rail transport in Nigeria, and concludes that decentralization and the ability to make fast, on-the-spot decisions gives trucking firms an advantage over the rails. See Hirschman (1967, 140–44).

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