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AN ESSAY ON CREDIT ARRANGEMENTS BETWEEN THE IMF AND THE REPUBLIC OF THE PHILIPPINES: 1970-1983

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This paper examines the significant stand-by arrangements between the Philippines and the International Monetary Fund from 1970 to 1983. It discusses the conditions of each agreement and its success in bringing adjustment. It attempts to show the little progress achieved through any of these agreements in effecting short-term adjustments or structural changes, and to explain why the Philippine government, which showed so little interest in adjustment, would conclude an almost unbroken series of credit arrangements with the Fund. The good housekeeping seal of approval, it is argued, indeed resulted from the IMF-Philippine credit agreements and assured the Philippines of a high level of foreign capital inflows during this period. It is concluded that rather than helping to achieve economic adjustment in the period 1970-1983, IMF credits may have actually enabled the Philippines to postpone measures that could have kept the country from falling into an economic crisis.

Introduction

The Philippines has had more stand-by credit arrangements (18) with the International Monetary Fund (IMF) than any other country except Haiti. These credits, which were accompanied by high levels of Fund conditionality, aimed at promoting financial stability in the Philippines by bringing about economic adjustment. Such adjustment included reducing the country's trade deficit and effecting structural changes in the economy, e.g. trade liberalization, needed to improve the country's international competitiveness. Yet, despite almost continuous IMF credits since 1962, the Philippines is experiencing its worst economic crisis since World War II. As one Fund official admitted to the authors: "We have something to answer for in the Philippines."

But precisely why the Fund is to be held partially accountable for the current economic debacle is a contested issue. One common-

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ly held view is that IMF 'dictation' of harsh austerity measures, devaluation, monetary restraint, etc., is responsible for the current economic state of affairs. This is to confuse causes with affects, however. A review of IMF credit arrangements since 1970 indicates that the 'dictates' of the IMF were often circumvented or simply ignored by the Philippine government. Fund conditionality only really became 'tough' when the crisis had already occurred, in 1970 and in 1983-84.

The aim of this paper is to examine the significant stand-by arrangements between the Philippines and the IMF from 1970 to 1983. The conditions of each agreement and its success in bringing adjustment will be discussed. We hope to show that little progress was made through any of these agreements in bringing about short-term adjustment or structural changes. We will then consider a possible reason why the Philippine government, which showed so little interest in adjustment, would conclude an almost unbroken series of credit arrangements with the Fund. IMF credits, it will be argued, served as a kind of 'good house-keeping seal of approval' which helped assure the Philippines of a high level of foreign capital inflows during this period. These loans, in turn, helped enable the Philippines to postpone necessary adjustments.

The IMF: History, Form and Functions

At the end of the Second World War, the international economy was threatening to revert to the autarchic policies of the Mercantilist era. This was expected as the inevitable result of a plethora of prolems that were then plaguing most countries: The destruction of productive capacities in most of Western Europe led to restrictions on exports and international trade in general, while an international monetary disequilibrium, caused by overvalued currencies at fixed rates, encouraged bilateral trading arrangements as well as the erection of tariffs and other trade barriers. It was the scenario of an impending international crisis that prompted the world's financial authorities to meet at Bretton Woods, New Hampshire in July 1944 to institute vital international monetary reforms designed for the normal functioning of a stable international economy from which all countries could benefit by way of expanded trade relations. From that conference emerged the International Monetary Fund and its sister organization, the International Bank of Reconstruction and Development (IBRD or World Bank).

The Fund operates on the basis of its members' pooled resources. When a country applies for membership, a quota for its capital subscription is determined, using such criteria as size and economic activity, relative to the other countries. Until a country surrenders its quota for capital subscription (in the form of 25 per cent gold, and 75 per cent in its domestic currency), it is precluded from availing of the Fund's resources. The Fund is run by a conference consisting of its members, but supreme authority resides in the Board of Governors, whose perfunctory functions it has delegated to an Executive Board, composed of five directors appointed by members with the largest quotas, and 14 other directors each for countries grouped according to some shared criteria. The Fund arrives at important decisions by a system of weighted percentage voting, which implies that the weight given to a country's vote is the proportion of its quota to the total resources of the fund. For example, the quota (and thus, voting power) of the major economic powers (U.S., Japan, and the European countries) amounts to about 40 per cent, while that for the Philippines is 0.5 per cent. For the most part, however, decisions are approved by consensus.

The Fund performs three functions simultaneously: regulatory, financial, and consultative. In its role as a regulatory agency, the Fund enforces the rules of the "Conduct of Good International Behavior" by eliminating conditions that hinder the smooth flow of economic transactions such as tariffs and other trade barriers, and incorrect currency valuation brought about by fixed exchange rate policies, while discouraging such disruptive policies as competitive devaluations. How the Fund is able to enforce such policies is accounted for by its financial role: it attaches different conditionalities prior to the granting of new facilities, or the continuance of those already in place. Generally, facilities for its first credit tranche, as well as those for other facilities (Compensatory, Oil, and Buffer Stock Facilities) that are meant for countries experiencing balance of payments difficulties as a result of factors that are temporary and are largely out of the control of the country, are subject to relatively low levels of conditionality. On the other hand, all the other facilities are associated with strict conditions, since their availment means or implies that the country is experiencing serious BOP problems that may be caused by structural impediments to adjustment in its economy, requiring major policy revamps.

As a whole, then, the Fund's purpose is to insure a stable international economy, conducive to the growth and development of international trade, while maintaining internal balance in the economies of its member countries (high or full employment, high and rising income, price stability, and internal financial stability).

1970 to 1975: An Overview

Consideration of the 1970 foreign exchange crisis cannot but lead one to view the present financial difficulties with a certain sense of *deja vu.* Mounting balance of payments pressure from 1967 onward led to increasing government reliance on foreign borrowing, particularly on short-term loans.[1] The payments imbalance reached crisis proportions after the November 1969 Presidential elections. As happened in the period leading up to this year's legislative elections, the last quarter of 1969 saw a 20 per cent jump in the money supply which was primarily the result of heavy government borrowing from the Central Bank to finance its electoral campaign. The result was a tripling of the budget deficit in 1969 over that of 1968 (Baldwin, 1975, p. 73).

If the immediate cause of the 1970 crisis was the President's desire to be reelected, the underlying reason was the expansionary fiscal and monetary policies and fixed exchange rate policy he pursued from his inauguration in 1966 which created higher demand for imports despite stagnation in the growth of the country's exports. Exports failed to expand significantly despite the passage of the Investment Incentives Act which aimed to stimulate manufacturing in high priority domestic and export markets. This was due to a heavily protected domestic sector which created an implicit bias against exports, duties still levied against exports, and an overvalued peso which weakened the country's competitiveness. The government attempted to stem the balance of payments deterioration by imposing foreign exchange controls reminiscent of the 'Filipino First' policy of the 1950s. The failure of this policy left accelerating foreign inflows (medium- and long-term borrowing jumped at 26 per cent yearly from 1965-69 and short-term debt rose even faster) as the only remaining prop for the economy. Finally a loss of confidence on the part of the foreign commercial banks after the electoral spending spree precipitated the crisis (Baldwin, 1975, pp. 72, 75; SM/84/91, p. 7).

If the roots of the 1970 crisis resemble those of the present one, the tough IMF requirement for approval of the 8th Stand-by Credit Arrangement was a precursor to the strong medicine the Philippines has had to swallow to secure the 18th Stand-by Credit. The 8th Arrangement, approved in February 1970, called for a substantial reduction in the rate of credit expansion (to be achieved largely

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[1] IMF Document #SM/84/91, May 4, 1984, "Supplementary Material for Prolonged Use of Fund Resources," p. 7.

through a government budget surplus), a sizeable depreciation of the peso, an improvement in the maturity structure of the country's external debt through a renegotiation of short-term loans and limits on the future expansion of the external borrowing by public financial institutions (SM/84/91, p. 7). In line with these conditions, the government floated the peso in February allowing it to fall to ₱6.40 from 3.90 against the dollar by the end of the year (Baldwin, 1975, p. 76). In May, reserve requirements were raised two per cent over a four-month period and the preferred rediscount rate to all rural banks granted by the Central Bank was raised from two to three per cent. The money supply (Net Domestic Assets) continued to expand despite these measures, but at a much lower rate than had been the case in the previous years (Baldwin, 1975, p. 79). The government was able to bring money supply under control largely because it had tightened its own fiscal belt. The budget recorded a ₱143 million surplus in 1970.

With the IMF agreement in hand, the Philippines was able to renegotiate most of its foreign debt. This rescheduling accounted for a $140 million increase in the total debt in 1970. But by 1971 the debt increased only $34 million, or three per cent, this being a much lower rate than the nearly 26 per cent annual increase from 1965-69.[2]

Despite slight modifications of the program approved by the IMF — the retention of certain restrictions in the exchange system and a slight loosening on the limits set on external borrowings and the balance of payments test — the Fund believed the outcome of the 1970 Arrangement to have been "quite favorable (SM/84/91, p. 11). In fact the report evaluating stand-by credit arrangements with the Philippines from 1970 to 1983 concluded that the 1970 program was "probabaly the most successful" because "a viable balance of payments position was achieved and maintained through 1973, despite an unfavorable external environment (SM/84/91, p. 18).

If Fund programs from 1970-73 were quite successful in improving the country's external position, a major problem occurred in 1973 which the Fund failed to adequately address. As a result of government failure to contain a rapid expansion in liquidity from the commodity price boom of 1973, money supply targets were widely missed under the 11th credit Arrangement (SM/84/91, p. 18). The

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[2] Baldwin, (1975), p. 79 and "Philippines — Request for Stand-by Arrangement," May 21, 1979, p. 59.

IMF had asked that Net Domestic Assets grow only 12.8 per cent in 1973 but the actual figure turned out to be 23.6 per cent. In hindsight an IMF report argues that this development, which they attribute to a lack of discipline on the part of the government, led to the unraveling of gains that had been achieved in Fund stabilization programs from 1970-72 (SM/84/91, p. 18).

The stricter conditionality that one might expect to find in the 12th Stand-by Credit (1974-75) in light of IMF concerns about the rapid growth in the money over the previous year is, surprisingly, not in evidence. Instead of requiring that monetary expansion be limited to the lower levels of 1970-72, we find the Fund programming a hefty 42.5 per cent increase, fully one-third higher than the previous year's growth (SM/84/91, p. 8). Furthermore, pressures on the balance of payments arising from this liquidity expansion as well as from the oil price shock of 1973 were not to be remedied by a devaluation of the peso or by a significant dampening of domestic demand (SM/84/91, p. 12). Rather, payments were to be brought into balance through a large increase in the level of medium- and long-term borrowing (SM/84/91, p. 12).

This pattern of light conditionality granted by the IMF and the weak performance achieved by the Philippines continued under the 13th arrangement of 1975. Limits on the expansion of liquidity, lower than that of 1974 though higher than those of the early 1970s, were widely missed (SM/84/91, p. 9). The trade deficit, initially projected to be \$40 million and revised upward at the mid-year review to \$700 million, reached a record \$892 million or 5.7 per cent of GNP. A small devaluation of the peso failed to significantly alter this imbalance (SM/84/91, pp. 9-13).

By 1976, then, the Philippines was experiencing another cycle of a worsening balance of payments situation propped by increasing high levels of foreign borrowing, which had led to the foreign exchange crisis of 1970. The stabilization measures of the early 1970s had proved to work only as long as they were applied. Subsequent arrangements which returned to light conditionality allowed the government to return to its old ways, with a rapid deterioration in the country's external position.

1976-1978: The Extended Fund Facility

It was under these circumstances that the Philippines requested an Extended Fund Facility (EFF) from the IMF, a medium-term arrangement designed for countries with chronic balance of payments difficulties. The EFF was created in 1974 to allow the IMF to work with a developing country for three years rather than for only one as was the case under a Stand-by Credit, in order to bring about the structural changes required to restore equilibrium in the balance of payments (Browning, 1979). So when the Philippines availed of the facility in 1976, the IMF set not only the standard fiscal and monetary targets but also performance criteria for structural adjustments as conditions for a loan. In return for this expanded conditionality, the Philippines received more credit from the IMF under the Facility than it had under previous arrangements. The program provided the country with 217 million Special Drawing Rights over three years, an amount which is nearly double the amount of the average credit granted during the first half of the 1970s (Ibon Databank Philippines, Inc., 1983, p. 118).

Though structural adjustment was the centerpiece of the program, little was actually accomplished in this area. An IMF evaluation of the Facility written in 1984 admits that progress "as regards the structural aspects of the program . . . was not evident (SM/84/91, p. 15). Targets for all three major areas of structural reform — infrastructure investment, taxes and resource allocation — were missed by a wide margin.

The investment program was designed to significantly expand the country's infrastructure, chiefly in power, irrigation, and transportation, in order to eliminate bottlenecks which have hampered private investment and production, particularly in the agricultural sector (SM/84/91, pp. 41-43). But "delays in project implementation" kept investment far below levels set under the program, even when these goals were revised downward. Worse, the Fund found that those projects completed were often of "doubtful economic justification" (SM/84/91, p. 17).

They also noticed a trend over the Facility's three years towards an increasing percentage of investments being financed by foreign borrowing. While foreign loans and grants constituted about one-fourth of the financing for public investment in 1976, they represented more than one-third in 1977, and still a higher percentage in 1978.[3] The Philippine government turned increasingly to foreign banks to finance public investment because the effort to significantly raise tax revenues had failed.

The tax reform program inaugurated under the EFF was the "key target" in the structural adjustment program because it was to

[3] "Philippines—Request for Stand-by Arrangement," May 21, 1979, p. 42; SM/84/91, p. 16.

be the means by which two major objectives of the program, increasing public investment and reducing levels of foreign borrowing, were to be reconciled (Philippines—Request . . ., 1979, pp. 44-47). The tax revenue/GNP ratio was to increase from 13.3 to 16 per cent in order to promote domestic savings which, in turn, could be drawn upon to finance higher levels of investment (SM/84/91, p. 13). Tax collection in the Philippines was notoriously inefficient and corrupt with income, corporate and real estate taxes being considered the worst performers (Browning, 1979). The government relied mostly on trade duties and indirect taxes, making the system a highly regressive one (Philippines—Request . . ., 1979, p. 44).

Performance in the program lagged from the very beginning. In 1977, realizing that there was little chance the targets could be met, the Fund revised the goal to a 14.5 per cent tax revenue/GNP level. But even this lower goal was missed; tax revenue to GNP grew only from 13.6 to 13.9 per cent under the EFF (Philippines—Request . . ., 1979, p. 44). A Fund evaluation attributed these shortfalls in tax revenues to "delayed implementation" of the real estate tax in 1977, postponement of reform of the income tax in 1978, as well as to the failure to close loopholes in corporate taxes.[4] The few new domestic taxes actually implemented were almost entirely indirect ones. This meant, therefore, that the program's overall "impact on after-tax income distribution was not important" (Philippines-Request . . ., 1979, p. 44).

The major emphasis in the arrangement's objective to improve resource allocation was tariff reform. The import-substitution industries which grew under foreign exchange controls in the 1950s had survived the lifting of these controls in the early 1960s through the creation of a complex tariff structure which continued to afford this sector a high level of protection (Philippines—Request . . ., 1979, p. 47). The most protected of these industries were those that produced nonessential consumer goods; intermediate and capital goods industries were afforded considerably less protection (Philippines—Request . . ., 1979, p. 47). The tariff policy under the EFF was to lower protection for consumer goods while raising tariffs on intermediate and capital goods. Though some headway was made when duty-free importation privileges for government corporations and private industries were abolished, the IMF conceded that on balance the program had been a failure (Philippines — Request . . ., 1979, p. 47).

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[4] EBS/78/249, p. 40 on real estate taxes, SM/84/91, p. 14 on income taxes and "Request for Stand-by Arrangement," May 21, 1979, p. 44.

The 1980-81 Stand-by Arrangement

The IMF team visiting Manila in preparation for the negotiation of the 16th Stand-by Arrangement must have recognized that the economic position of the country had changed significantly since early 1979. (The 15th Stand-by Arrangement was approved in June 1979 and ran through the first half of 1980.)

A 33 per cent increase in the price of OPEC crude oil, imposed on December 1, 1979, was estimated by the Central Bank Governor to add $350-400 million to the country's oil bill in 1980 (Bulletin Today, Dec. 23, 1979). Proportional increases in the price of all petroleum-based products signalled that the domestic economy was in for a major external shock in 1980 (SM/84/132, p. 91).

The domestic inflation rate had reached 18 per cent per annum in 1979 and appeared to be heading higher in light of both the impending oil shock and government monetary policy (EBS/80/159, p. 7).

The current account deficit had registered a significant jump: from -$1,102 million in 1978 to -$1,497 million in 1979 (SM/84/132, p. 44). At the same time the balance of payments deficit had grown at an alarming rate: from $86 million in 1978 to $603 million in 1979 (SM/84/132, p. 44).

It is true that exports had increased over 1978 levels in dollar terms from $3,425 to $4,601 million (SM/84/132, p. 44). Yet a closer look at the figures reveals that higher world commodity prices played the major role in the said increase, as the volume for most traditional exports either declined or remained roughly unchanged.

Nontraditional exports were growing robustly during this period with a 41.5 per cent increase in value from 1978 to 1979 (SM/84/132, pp. 111-112). Yet the total value of these exports was still small when compared to the total value of RP exports (SM/84/132, pp. 111-112). More importantly the value-added component of most nontraditional Philippine exports is quite low and the import content extremely high (Ranis, 1984, p. 4).

Moreover, the combination of the second oil price shock and the expected downturn in the world economic cycle had economists predicting recession for the approaching period, a prediction which proved to be painfully true. [5] Since an international recession almost

[5] "Philippines—Recent Economic Development," Document #SM/82/66, April 9, 1982, p. 1.

always means stable or declining prices and markets for primary commodities, and even nontraditional exports, such a prediction should have signalled a limit on the ability of increased export earnings to finance further large increases in imports or capital repayments.

Two further items that must have triggered concern, especially in light of the predicted drop in export growth, were the sizeable increases in the inflow of foreign medium- and long-term capital while the amount of net foreign direct investment in the Philippines was declining by 80 per cent over the same period (SM/84/132, p. 44).

These alarming external and internal developments called for one of two painful remedies. Traditional policy responses to this type of situation are categorized into either domestic policies to dampen aggregate demand such as reduction in the rate of growth of the money supply and a corollary reduction in the rate of growth of public expenditures and government deficits, or a major devaluation of the country's currency, or a combination of both.[6]

Without strict conditionality and numerous program targets, the first policy depends heavily on the government's good-faith efforts at fiscal and monetary restraint even though such policies are likely to entail substantial short-term domestic difficulties. On the other hand, requiring a programmed devaluation along with tight monetary and fiscal targets allows the government less opportunity to circumvent the agreed-upon program.

In what must be interpreted as a dismissal of recent historical lessons, the Fund constructed the 16th stand-by Arrangement on the premise of a good-faith effort by the government to fulfill its politically costly obligations and thus relied heavily on policy prescription number one with light conditionality.

Actual quantitative performance criteria were placed on only four macroeconomic aggregates which proved inadequate in the face of the impending difficulties, and more importantly, in light of the government's historic aversion to painful but necessary economic discipline.

Two of the criteria — Net Credit to the Public Sector and Net International Reserves of the Banking System — were exceeded before the end of the first half of 1980 in the former case with the Fund's approval (EBS/80/159, p. 4).

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[6] Interview with Hiroyoki Hino, current IMF Representative to the Philippines, October 2, 1984.

Net Credit to the Public Sector was programmed to increase by 30 per cent by the end of 1980. However, by March of 1980 the Philippines had exceeded the target and was forced to submit a request for revision.

Warning bells most definitely should have gone off when Finance Minister Virata and Central Bank Governor Licaros explained the government's use of this extra credit: "placement of government funds with the Development Bank of the Philippines (DBP), amounting to ₱0.8 billion for on-lending to small and medium-scale industries as well as export oriented firms . . ." (EBS/80/159, p. 4).

Today, over 75 per cent of DBP's domestic loans are nonperforming (SM/84/132, p. 41) and the large majority of the loans made by DBP in the late '70s and early '80s are estimated by independent analysts to have been political in nature.[7] Said a top foreign banker: "I have never known a government development bank that was not plagued by corruption and DBP is one of the worst."[8] The Fund's unquestioning acceptance of the RP "explanation" demonstrated that the Fund was willing to accept at face value the government's assertions concerning the operations of its public development financing institutions. It was the rapid, unchecked expansion of these institutions' capital base, loan profile and loan guarantee programs that would have such disastrous results just a few years later.[9]

The originally targeted decrease in Net International Reserves of the Banking System (NIRBS), the second performance criterion, was a hefty 87 per cent from December 1979 to December 1980 (EBS/80/159, p. 4). (NIRBS had been negative since 1978.) Making this figure more intriguing is the tacit admission by government officials

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[7] Interview with a leading foreign banker and a Philippine official with intimate knowledge of DBP accounts.

[8] Interview with a leading foreign banker, name withheld on request, September 1984.

[9] As of June 1984, the largest government financial institutions reported the following difficulties: Philippine National Bank listed 9 of its 10 largest loan accounts as "non-performing"; Development Bank of the Philippines admitted that only 24 per cent of its outstanding loan accounts were making repayments on both interest and principal and fully 67 per cent were nonperforming (private analysis estimates the latter figure to be closer to 75 per cent) and Philippine Guarantee stated that 80 per cent of its guaranteed loans due in 1983 were nonperforming and another 80 per cent of those due in 1984 were in the "high risk" category (SM/84/132, p. 41). The majority of these bad loans were made in the period from 1980 to 1983.

that the government was engaged in window dressing to meet NIRBS targets (*Business Day*, March 7, 1984). So instead of monitoring the actual amount of NIRBS, the IMF was monitoring the ability of the CB to "dress up" its figures at the end of each quarter. The real rate of growth at year's end was estimated by the Fund to have been 2.4 per cent. Philippine authorities disagreed, however, and announced a growth rate of 4.8 per cent (still significantly below the original target). Although an IMF internal memo indicated that there was no quantitative support for the higher figure, a compromise was reached at 3.8 per cent.[10] After a year of good growth in 1980, exports actually dropped in 1981 (SM/84/132, p. 44). This spelt immediate trouble for the country's debt-service ratio, which as explained above, had already been significantly understated.

A third program limit, that on Net Domestic Assets of the Banking System, was exceeded by a wide margin by mid-1981 as the government scrambled to bail out corporations hit by the fallout of the Dewey Dee scandal.[11]

The fourth criterion was a "limit" on foreign borrowings. The 1980 Agreement calls for "an overall limit of $1.2 billion for approvals of new loans with an initial maturity in the 1-12 year range (EBS/80/160, p. 14). This was perhaps the waterloo of an already weak program. By again placing short-term monetary and non-monetary inflows, Official Development Assistance and other long-term foreign loans flows outside the jurisdiction of the Agreement, the signatories rendered this Program "ceiling" meaningless.

In 1980, short-term external debt alone increased by $2.2 billion, almost double the entire program limit. In total, RP foreign debt in 1980 increased to $17,122 million from the 1979 total of $13,192 million or an increase of 30 per cent in one year (SM/84/132, p. 72). Belying Philippine-IMF claims that the structure of foreign debt had improved over the period, short-term debt went from 39.9 per cent of total foreign debt to 43.7 per cent from 1979 to 1980 (SM/84/132, p. 72).

The gravity of such an increase in foreign debt over a period of one year cannot be underestimated. That it propped up the peso at uncompetitive rates, thus harming the current account position of

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[10] "Philippines—Staff Report for the 1982 Article IV Consultation-Supplementary Information," Document #SM/82/155, July 14, 1982.

[11] "Philippines Stand-by Arrangement: Review and Modification," Document #EBS/81/160, July 30, 1981, p. 27.

the country (which declined from $1,497 million in 1979 to $1,904 million in 1980), is beyond dispute. That it strained the on-lending facilities of the government beyond the point of competence is demonstrated by the fact that 70 per cent of the domestic loans made by the CB from funds acquired under the Consolidated Foreign Borrowing Program are not currently making repayment (SM/84/132, p. 42). Perhaps worst of all, the hemorrhaging of foreign loans that began with the advent of the EFF and deteriorated under the 1980 agreement, served by the means listed above to mask the depth of the country's structural economic problems, thus setting the stage for the crisis of 1983.

An analysis of the mid-year staff report for 1980 reveals that the Fund had no idea of the magnitude of the short-term debt problem. Blandly noting that by end-May 1980 new foreign loan inflows of 1-12 year maturities had already reached 56 per cent of the target limits, it fails to mention even the possibility of a large inflow of loans falling outside the criteria established in the program (EBS/80/159).

Just how badly the Fund had been fooled is highlighted by the assertion of its Staff Report of July 17, 1980 (EBS/80/159, p. 12) that short-term foreign borrowings in 1979 registered a "moderate outflow." Actually, as of 1984, the Fund report (SM/84/132, p. 72) explains that short-term debt had increased by over $1.5 billion during 1979.

Given the general lack of compliance with agreed-upon targets, it is not surprising that the Philippine economy failed to reach program goals for inflation or economic growth (EBS/81/160, p. 2). Meanwhile, the overall balance of payments deficit grew to 1.5 per cent of GNP in 1981, compared with the original program target of overall equilibrium (EBS/84/104, p. 17).

Another failing of the 1980 program, the devaluation of the peso, was apparently not programmed. Decisions on any programmed depreciation of the exchange rate are not included in documents circulated within the Fund. However, the fact is that "the peso/dollar exchange rate was maintained, resulting in an appreciation of the real effective exchange rate (EBS/84/104, p. 17). That the Arrangement was not suspended seems to indicate that an effective devaluation of the peso was not a program criterion.

Internal Fund documents (EBS/80/159, p. 3) show that IMF officials nonetheless recognized the need for a devaluation:

> The policy of keeping the exchange rate of the peso closely in line with the dollar has led to wide fluctuations in the exchange rate of the peso vis-a-vis the currencies of other important trading partners. The trade-weighted effective exchange rate of the peso appreciated, in nominal terms, by over 6 per cent between December 1978 and April 1980; over the same period there was a deterioration in the relative price performance of the Philippines.

Philippine authorities, however, appear to have dissuaded the IMF from demanding devaluation as a performance criterion in the 1980 arrangement. Philippine authorities argued that: 1) the current level of exchange rate was broadly appropriate; 2) export growth continued to be high; 3) there was an absence of "firm evidence" that domestic producers are becoming uncompetitive on international markets; 4) "present balance of payments problems were not susceptible to exchange rate action"; and 5) a depreciation of the exchange rate would only aggravate the existing inflationary pressures (EBS/80/159, p. 3). When examined closely, however, these five lines of defense appear to be somewhat tenuous.

Judging whether or not present exchange rates are "broadly appropriate" is a delicate business at best. One of the most prominent indicators used in such an analysis is the change in the differential between the prevailing exchange rate in the black market and the official rate. From an interview with Hiroyoki Hino, the current IMF Resident Representative to the Philippines, it appears likely that the IMF would have taken this factor into account in assessing the authorities' claim that the then official exchange rate was "roughly appropriate."

In light of this, the authors were fascinated to learn from extremely reliable sources that at least until the early '80s, the Philippine Central Bank was intervening directly in the "Binondo" black market with the sale of large amounts of the intervention currency (the U.S. dollar) by its affiliate, the Philippine National Bank. Although our source indicated that the primary motivation behind such action was to hurt black market traders and to facilitate their "financial cooperation" with certain highly-placed government officials, the procedure undoubtedly kept the black market-official rate differential at a low and relatively stable level through at least 1980. This would have had the secondary effect of supporting Philippine claims concerning the viability of then current exchange rates.

The contention that there was no "firm evidence" that domestic producers were becoming unproductive on international markets is belied by the relative increase of the prices of Philippine products vis-a-vis those of six neighboring Southeast and East Asian states throughout the late 1970s (EBS/80/159, p. 4a). Furthermore, the fact that the trade-weighted effective exchange rate of the peso appreciated by over 6 per cent between December 1978 and April 1980 would call into question such a claim (EBS/80/159, p. 33).

Finally, although it is most probably true that the devaluation of the peso in 1980 would have led to a round of cost-push inflation, the assertion that the present balance of payments problems were (not) susceptible to exchange rate action is overstated (*Business Day*, October 16, 1984, p. 1).

However unconvincing the defense of the current exchange rate by Philippine authorities seems to us now, IMF officials accepted it. Instead of a programmed devaluation the Fund appears to have accepted government promises to permit greater flexibility in the exchange rate and to utilize a basket of currencies in setting the peso exchange rate (EBS/80/159, p. 14). Unfortunately, the Philippines failed to make good on its stated intent. No significant devaluation of the peso occurred until the spring of 1983 (a delayed reaction to an IMF request as part of the 17th Stand-by Arrangement) and as of today the basket of currencies system has not been implemented.

In the period 1980-81 world recession weakened Philippine exports and the "Dewey Dee" scandal jolted its financial system. But rather than adjust to a deteriorating external situation or use a crisis in domestic financial markets to initiate needed reforms, Philippine authorities pursued expansionary policies financed by foreign loans. Instead of demanding firm action such as a programmed devaluation, the Fund watched its targets fall one by one, sometimes even adjusting them upward on the request of the government. Finally, the IMF failed to demand the monitoring of short-term debt which by the end of the program comprised almost half of the total debt.

Developments During 1982

Nineteen eighty-two was only the second year since 1962 in which there was no Stand-by Credit Arrangement between the Philippines and the IMF. The only other gap in what was otherwise a continuous series of agreements came in 1969 when the incumbent President rode to reelection on a rising tide of liquidity which soon caused considerable economic flood damage. If the President's re-election campaign blocked a credit agreement in 1969, a salvage effort for businessmen closely connected with the President is largely to account for the absence of one in 1982. When Dewey Dee's flight precipitated a financial crisis of confidence in early 1981, the IMF and the Philippines agreed to a 'rescue fund' to bail out troubled 'crony' corporations. But when under political pressure the government unilaterally doubled the size of said fund from $193 to almost $400 million, the Fund vetoed the Government's attempt to secure an IMF credit for 1982.[12] The Philippine economy unraveled quickly during the year with the balance of payments and the government budget deficits hitting record highs.

1983: The 17th Stand-by Arrangement

By the beginning of 1983, the Philippine economic situation had reached crisis proportions. The Aquino assassination eight months later was only to reveal that "the emperor had no clothes on" (Ranis, 1984, p. 8). The Philippines was borrowing from abroad at clearly unsustainable levels, particularly in terms of the short-term credit, in order to attempt to bridge the yawning balance of payments gap which had widened further in 1982. By the latter part of that year, some foreign bankers and certain technocrats were calling for an immediate moratorium on and restructuring of the country's external liabilities.[13] Apparently, the President refused because he did not want the Philippines compared with certain Latin American countries then going through debt rescheduling.[14] Instead, the Philippines turned to its old 'stand-by', the IMF. This time, however, the country no longer received the relatively light conditionality to which it had grown accustomed during much of the 1970s and early 1980s. Still smarting over the Dewey Dee bail-out and clearly worried by adverse developments during 1982, the Fund proposed some painful remedies for the Philippines' economic ills.

The chief objectives of the 17th Stand-by Credit Arrangement, which became effective in February 1983, was to reduce the balance of payments deficit by one-half (to $600 million) from that reported in the previous year (EBS/84/117, pp. 7 and 37). This was to be accomplished through performance criteria which limited the in-

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[12] "Philippines—Staff Report for 1982 Article IV Consultation," March 24, 1982, p. 9, cited in Bello op. cit., p. 192.

[13] Interview with Dr. Castro, UP Professor of Economics, September 10, 1984.

[14] Ibid.

crease in net domestic assets, slowed government loans to public corporations and placed ceilings on foreign borrowings, including for the first time a sub-ceiling on short term nonmonetary debt (though this still left half of short-term credits unmonitored).[15]

The government's unwillingness to adjust through most of 1983 led to developments which "turned out to be quickly and sharply at variance with the program's objectives . . ." (EBS/84/117, p. 8). As an IMF report states in a staff appraisal: "Throughout 1983, delays in the recognition of the extent of the external deterioration led to the postponement of an adequate domestic response" (EBS/84/117, p. 9).

By mid-year it was already clear that the program targets were in shambles -- the balance of payments deficit and the money supply, even though underreported, had already surpassed agreed upon limits. In response, the Philippine government attempted some half-hearted measures to ameliorate the situation.[16] The peso was devalued by 7.3 per cent, prices for petroleum and other products were raised and growth in the money supply was slowed (EBS/84/117, p. 12). This was, to the Fund's mind, too little and it was also too late. So for the first time in their long relations, the IMF terminated a program with the Philippines. Only 100 of the 315 million SDRs to be lent to the Philippines under the program were disbursed, as it was discontinued during summer 1983 after only two of the Arrangement's four tranches were released (EBS/84/117, p. 47; EBS/83/24, p. 58).

The IMF was not in the best position to handle the difficulties that arose under the 17th Stand-by Arrangement because it did not at the time have a 'Resident Representative' in the Philippines who could have closely monitored the situation and given accurate reports to the IMF as well as to foreign creditors of the country. The Fund's last representative to the Philippines had been Julio Jimenez who left in December 1980 after he clashed with then Central Bank Governor Licaros. Jimenez, a blunt man whose proclivity for calling "a spade a spade" rankled tender Filipino sensibilities, angered Licaros who

[15] EBS/84/117, pp. 7 and 9; for a breakdown of short-term debt into monetary and nonmonetary categories, see SM/84/132, p. 72.

[16] EBS/84/117, p. 8 showing monetary targets had been 'substantially' exceeded, and p. 12 indicating that the year's target for the trade deficit had already been exceeded after six months.

refused to give Jimenez statistical data for the balance of payments, international reserves and gold reserves.[17]

After nearly a year in which there was no IMF official based in the Philippines, Kemal Sieber arrived in late 1981 under circumstances disputed by several observers. According to one account, Sieber came merely as a Consultant to the Central Bank on the Bank's initiative to help draw up "charts and graphs" with no responsibility to the Fund. According to another version, however, Philippine authorities requested Sieber's appointment by the IMF as Representative based on his early performance in this capacity to the Philippines in the early 1970s. Unusual for an IMF representative, Sieber had been well liked in the Central Bank which prompted them to request that he fill the job again. The Fund refused to send Sieber as a representative, but a compromise was reached allowing him to come as a consultant in which he was expected to report periodically to the Fund.

Whatever the circumstances of his arrival were, it is clear that Sieber's performance was a particularly unfortunate one. Several sources indicate that Sieber had an extremely 'cozy' relationship with the then CB Governor Jaime Laya.[18] Sieber, reportedly claiming to speak for the IMF, gave foreign creditors assurances as late as August 1983 that all was well with the Philippine economy. This led several banks and one embassy to complain to the IMF that they had been misled by Sieber.[19] As one banker described it:

> Laya, who was extremely persuasive anyway, would give briefings (to foreign bankers) where he would admit problems existed. But then he would pull out one of those graphs Sieber had made — those things were really terrific — and show how these problems would soon be corrected. And everyone believed him. There are a lot of people who say they saw the crisis coming. But I doubt anyone who sat through one of those briefings was not convinced (that the country's economic situation would soon improve) . . .[20]

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[17] Interview with Alexander, reporter for the *Economist*, October 18, 1984.

[18] Sources, who wish to remain anonymous, include several bankers and a high ranking ADB official.

[19] Interview with an official familiar with IMF procedures (name withheld on request).

[20] Interview with a foreign banker (name withheld on request).

It was not until January 1984 that Hiroyoki Hino arrived, the first full-time IMF Resident Representative since 1980. In the meantime, the Philippine economy had come unstuck.

The IMF's 'Good-housekeeping Seal of Approval'

From the viewpoint of the Philippine government, one of the chief advantages of operating under almost continuous IMF arrangements was the so-called good-housekeeping seal of approval they assumed it gave their country in the eye of foreign commercial bankers. Philippine officials interviewed in 1979 said they believed that without stand-by arrangements the country would have difficulties obtaining the foreign commercial credit to which it had become dependent (Browning, 1979). The World Bank's 1980 Country program paper states: "The Government regards the IMF's role as essential not only for the large volume of resources provided, but also for the reassurance on economic management provided to private sources of finance."[21]

Symbolic perhaps of the importance the Philippine government placed on its image in international financial markets was their hosting of the joint meetings of the board of governors of the IMF and World Bank in Manila in 1976. The government went to great lengths to demonstrate that the Philippines was a wise choice for major foreign investors.[22] Sixto K. Roxas III, then President of Bancom Development Corporation, explained the "not intangible benefits" of close cooperation with the IMF, including the hosting of their annual meeting:

> The image which we build is very important because in banking, like anything else, there are fads. There will be fads for a particular country. This means all of a sudden the credit of a particular country becomes hot in the market, a situation wherein everybody tries to push financing to that country. I think the Philippines is very much in this position now . . . Becoming a fad is important for a country if this kind of effect happens — being faddish as a place where investors place money (*Daily Express*, October 4, 1976).

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[21] World Bank *Country Program Paper*, p. 13 cited in W. Bello *et al.*, *Development Debacle*, p. 178.

[22] Government preparations for the meeting included the construction of high walls around major squatter areas in Manila to prevent delegates from viewing the extent of urban poverty. See *Revolution in the Philippines*, pp. 25, 317-318.

The belief that the 'seal of approval' operating under the IMF arrangement provided would help make the Philippines something of a fad in foreign financial circles appears to be not unfounded. The extent of external loan flows under the EFF has already been documented. The *Asian Wall Street Journal's* Jim Browning (1979) spoke to several financial analysts who believe that "Philippine dependence on the IMF has gone so far that banks will make government-guaranteed loans to the Philippines almost blindly so long as they do not withdraw support — but that the banks would stop much of the credit at any sign of a serious rift with the IMF.

Such evidence leads us to view the IMF credit arrangements with the Philippines in a new light. While the chief objective of the IMF was to effect short-term and structural adjustments in the Philippine economy, it seems the government's aim was to increase foreign inflows in which IMF agreements played a crucial part. Agreeing to adjustment measures was essential in securing IMF approval of credit arrangements. But as we have seen the Philippine government was able to delay or slow implementation of many aspects of these programs without losing IMF approval. The ability of the government to postpone measures that might have been politically costly while maintaining high loan flows enabled the country to continue what Professor Gustav Ranis has called the "debt driven growth of the 1970s."[23]

Conclusion

In this paper it has been argued that the IMF, despite its reputation for stringency, actually enabled the Philippines to postpone adjustment from the mid-1970s up to the early 1980s through Standby Arrangements of light conditionality and by helping to maintain the country's credit rating in foreign financial circles.

As the Fund's own recent evaluation of its programs since 1970 admits, aside from successful arrangements from 1970-72, results "have, at best, been mixed." Loose targets and government willingness undermined the economic stabilization which the Fund's annual financial programs were designed to bring about. Liquidity, which was contained in the early 1970s, expanded rapidly through-

[24] Gustav Ranis, "Prepared Statement of Gustav Ranis before the Subcommittee on Asian and International Affairs: Brief Reflections on the Philippine Economy," Committee on Foreign Affairs, U.S. House of Representatives, September 20, 1984.

out the rest of the decade and into the early 1980s. The peso, which the Fund mistakenly believed was floating in the 1970s, actually appreciated in real terms in 1981 despite a Fund call for a devaluation. A subsequent devaluation in 1983 proved too little to stem a foreign exchange crisis. Most crucially, perhaps, the Fund's lack of alertness allowed the Philippines to circumvent ceilings on long- and medium-term loans by recourse to short-term credit which is the major component of the present debt crisis.

Structural adjustment was, if anything, less successful than the quantitative aspects of Fund programs. The EFF really never got off the ground; as public investment lagged from the beginning, the tax to GNP ratio rose only slightly during the program but declined quite substantially thereafter and no progress was evident in regards to trade liberalization.

As for the so-called good housekeeping seal, interviews with government officials and foreign bankers indicate that however unintended, this was indeed a result of IMF-Philippines credit agreements. We have seen that an IMF arrangement was a kind of self-fulfilling prophecy for the Philippines. Relatively optimistic targets would be set for growth and the trade account. This, in turn, would help maintain the country's credit rating. The loans which the Philippines secured on the basis of this financial good standing would help bridge the trade deficits which resulted from progressive deterioration in the current account and enable the country to achieve growth, albeit, debt driven.

Rather than helping to achieve economic adjustment in the period 1970-1983, IMF credits may have actually enabled the Philippines to postpone measures that could well have kept the country from falling into an economic crisis.

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Appendix — Philippines: Stand-by Credit Arrangements With the IMF (Million SDRs)

		Amount	Drawn
First	(4-12-62 — 4-11-63)	40.40	—
Second	(4-12-63 — 4-11-64)	40.40	—
Third	(4-12-64 — 4-11-65)	40.40	—
Fourth	(4-12-65 — 4-11-66)	40.40	—
Fifth	(4-12-66 — 4-11-67)	26.70	—
Sixth	(1- 5-67 — 1- 4-68)	55.00	55.00
Seventh	(3-15-68 — 3-14-69)	27.50	27.50
Eighth	(2- 3-70 — 2- 2-71)	27.50	27.50
Ninth	(2- 2-71 — 2- 2-72)	45.00	35.00
Tenth	(4-27-72 — 4-26-73)	45.00	35.00
Eleventh	(5-16-73 — 5-15-74)	45.00	—
Twelfth	(7-16-74 — 7-15-75)	38.75	38.75
Thirteenth	(5-31-75 — 5-30-76)	29.06	29.06
Fourteenth[1]	(4- 2-76 — 12-31-78)	217.00	217.00
Fifteenth[2]	(6-11-79 — 6-10-80)	105.00	91.25
Sixteenth[2]	(2-27-80 — 12-31-81)	410.00	410.00
Seventeenth[3]	(2-25-83 — 8-14-83)	315.00	100.00[4]

[1] Under the Extended Fund Facility

[2] Under the Supplementary Financing Facility and Ordinary Drawing Facility.

[3] Includes compensatory financing of 188 million SDRs.

[4] 3rd and 4th tranches, scheduled for November '83 and February '84 withheld.

Sources: Ibon, *The Philippine Financial System*, p. 118; EBS/84/117, p. 47; Termination of 17th SBA discussed with L.S. Itchon, September 24, 1984.