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Debt or Development: Philippine Imperatives and The Conventional Strategy for Debt Management

by

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A b s t r a c t

Conventional debt strategy claims to be growth oriented. This paper argues however that effectively, growth is treated as a residual after debt service requirements are met. This is borne out by results of Philippine negotiations with the IMF in 1986 and 1988.

Owing to this, the prospects for achieving the country's development targets over the medium-term are dim. Current debt conversion schemes and the Philippine Assistance Plan may bring only negligible benefits to the country at best.

DEBT OR DEVELOPMENT:
PHILIPPINE IMPERATIVES AND
THE CONVENTIONAL STRATEGY FOR DEBT MANAGEMENT

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I. Introduction

After the "people-power" revolution in the Philippines in 1986, the restored democracy found itself facing serious problems: an economy that had contracted by over 15% in the previous two years following its debt moratorium with the international commercial banks and subsequent "stabilization programs" with the IMF; real income levels down to the level of a decade before; nationwide unemployment of 12% and underemployment of 38%; double-digit inflation; and almost 60% of families living below the poverty line. The Philippines' external debt was more than five times the level of a decade before, reaching 94% of GNP, with a debt-export ratio 3.3. Servicing that debt took 34% of exports of goods and services and amounted to 9.7% of GNP, 6.6% of which was in interest payments. The country's debt service obligations exceeded inflows from foreign creditors. This net resource transfer amounted to 5.6% of GNP. Tables 1 to 4 show data on the external debt situation of the Philippines, and also compares the Philippine situation with other Pacific basin countries.

This paper outlines the directions envisioned under the Philippines' Medium-Term Development Plan (1987-92) describes the results of its efforts under the constraints of conventional international debt management strategy, and analyzes the prospects for sustaining economic growth over the medium-term.

The rest of this section will be devoted to an overview of the current development plan and the conditions necessary for its accomplishments.

The next section presents an organizing framework that brings out some of the key parameters needed for growth and the inherent tensions that the conventional approach to the debt problem debt creates.

The third section discusses the approach to planning taken by conventional debt strategy as a growth-residual rather than a growth-oriented approach, and describes the Philippine economic performance for 1987-1988, within the constraints of this approach, as well as the results of its recently concluded negotiations with the IMF for 1989-1991.

The fourth section analyzes the prospects of the Philippines vis-a-vis attaining its stated development objectives over the rest of its medium-term plan period (1989-1992), within the latest IMF framework, and discusses the possible effects debt conversion schemes and the U.S. Multilateral Assistance Initiative would have on the prognosis.

The last section presents the summary and conclusions of the paper.

Overview of the Medium-Term Philippine Development Plan, 1987-1992

The Medium-Term Philippine Development Plan, 1987-1992 sets four major goals, namely: 1) alleviation of poverty; 2) generation of more productive employment; 3) promotion of equity and social justice; and 4) attainment of sustainable economic growth.

In quantitative terms, real GNP is targetted to grow by an annual average rate of 6.5%. At this rate, the highest real per capita income achieved in 1981 will be regained by 1991. It must be noted that this growth target is what is expected as the average performance of the countries in the Asia Pacific region in the medium-term.

The unemployment and underemployment rates are projected to decline respectively from 12.5% and 38% in 1985 to 4.6% and 25.2% in 1992. The underemployment rate is the proportion of those employed who worked for less than 40 hours a week during the reference period.

Poverty incidence is expected to fall from about 60% in 1985 to 45% in 1992.

On the other hand, the inflation rate, which averaged 3.8% in 1987 and 8.8% in 1988, is envisioned to remain at a single digit level.

In order to achieve these objectives, the government would pursue a rural-based, employment-oriented development strategy. This approach is imperative because:

1) Unemployment and underemployment are serious problems.

2) Two-thirds of Filipinos reside in the rural areas where poverty is more pervasive and acute.

3) This strategy is the most effective way of simultaneously addressing the objectives of poverty alleviation, employment generation, and income and wealth redistribution.

The underlying thrusts of policy are to:

a) Improve efficiency in both the government and private sectors;

b) Remove the biases against the agriculture and rural sectors and improve the access of the poor to land, credit and other productive assets; and

c) Enhance the effectiveness of delivery of basic social services.

These policy directions were expected to lead to a sustainable broad-based, private sector-led development.

Wide ranging structural reforms have already been implemented in both the economic and social spheres since 1986. These reforms laid the groundwork for sustained economic growth among others, by improving the government's ability to generate tax revenues and to implement infrastructure projects, improving the efficiency of financial intermediation and revitalizing government financial institutions, reducing the presence of government corporations and other forms of government intervention in business activities, and removing distortions in the commodity and factor markets.

The economic reform package instituted included those in the following areas:

1. Tax Reform
2. Privatization
3. Deregulation
4. Trade Reform
5. Rationalization of Investment Incentives
6. Strengthening of the 2 largest GFIs
7. Financial Sector Reforms
8. Improvements in the Infrastructure Program
9. Decentralization

On the other hand, social reforms included the Comprehensive Agrarian Reform (CARP), and expanded social services.

But internal structural reforms, although a necessary condition, are not sufficient. The aim of these reforms is to be able to use existing resources in a more efficient and equitable manner. But if the resources required are to be available, external cooperation is necessary to reduce the net resource outflow to creditors that the country is experiencing. The economy must be allowed some breathing room to grow, and thus not only fulfill its obligations to its people, but also increase its capacity to pay. How much external cooperation is required, and why, is answered in the succeeding sections.

II. THE IMPACT OF EXTERNAL DEBT ON GROWTH:

AN ORGANIZING FRAMEWORK

The discussion below will be focused on the following simple planning for-growth accounting model, designed to bring out some of the key parameters needed for growth, as well as to show how the debt burden impacts on them.

$$(1) \quad I^*_t = kg^*Y_{t-1}$$

$$(2) \quad I^*_t = S_{p_t} + S_{g_t} + S_{f_t}$$

$$(3) \quad I^*_t = I^*_{p_t} + I^*_{g_t}$$

$$(4) \quad (I^*_p - S_p) + (I^*_g - S_g) = S_{f_t}$$

where Y = output

g^* = targetted growth rate

I^*_t = investment levels needed to achieve output level

S = savings

k = incremental capital output ratio

$I^*_g - S_g$ = public sector deficit

The subscripts p, g, and f refer to private, public and foreign sector, respectively.

A growth-oriented approach would determine the level of investments I^* needed to achieve the desired output growth g^*. Financing this investment would require savings from domestic (S_P and S_g) and foreign sources (S_f, which is the current account balance).

The amount of savings (current revenues minus current expenditures) the Philippines can mobilize to finance the investment require to achieve its targetted output level is greatly constrained by the burden of its external debt. Interest payments on external debt form a large part of its current expenditures. The larger the expenditures, the less the savings for a given level of income and the larger will be the deficit for a given level of investment. For example, in 1986, interest payments to foreign creditors alone amounted to 6.4% of GNP (see Table 3), while the total debt burden was 9.7% of GNP. The public sector deficit, on the other hand, was 4.8% of GNP.

The options open to the country are unenviable:

(a) control/reduce its interest payments, e.g., put some sort of interest cap. This goes against the conventional international debt approach, which requires <u>full</u> interest servicing.

(b) reduce its other current expenditures. For the private sector, this means "eat less." For the national government, this means cutting back on its ability to provide basic services such as health and education. Already, the per capita government operating expenditures net of interest payments in 1986 were about 20% lower in real terms than the 1976 figure.

(c) increase its revenues through additional taxes. First, one must bear in mind that the economy has just emerged from a state of collapse. Furthermore, the tax system in place is quite

TABLE 1

PHILIPPINE EXTERNAL DEBT
1970-1988

Year	Level ($M)	Ratio to Nominal GNP (%)	Ratio to Export of Goods and Services (%)
1970	2,297	33.90	174.02
1971	2,393	31.02	170.81
1972	2,732	32.60	188.02
1973	2,886	27.01	114.30
1974	3,755	25.52	105.51
1975	4,939	31.28	154.30
1976	6,768	37.52	196.46
1977	8,069	38.98	190.49
1978	10,694	44.50	217.84
1979	13,352	45.18	213.43
1980	17,252	48.99	215.38
1981	20,893	54.36	242.43
1982	24,677	62.83	308.31
1983	24,816	72.81	305.16
1984	25,418	80.49	317.05
1985	26,252	81.72	331.59
1986	28,256	93.71	327.30
1987	28,649	83.78	310.83
1988	27,915	71.48	261.38

Source of Basic Data: Central Bank of the Philippines.

TABLE 2

PHILIPPINE EXTERNAL DEBT, BY MATURITY AND BORROWER*
(Leve in Million US$)
1983-1988

	Short-term		Long-term		
	Public	Private	Public	Private	Total
1983	4,344	5,060	12,386	3,026	24,816
1984	4,665	4,827	12,883	3,043	25,418
1985	4,083	4,490	15,039	2,640	26,252
1986	2,643	2,735	19,186	3,692	28,256
1987	1,914	1,878	20,837	4,020	28,649
1988	1,823	1,938	20,845	3,309	27,915

*Breakdown by maturity and by borrower are not available for 1970-1982 series.

Source: Central Bank of the Philippines.

TABLE 3

PHILIPPINE DEBT SERVICE BURDEN[1]
1971-1988

Year	Debt Burden (US$M)	Principal Payments (US$M)	Interest Payments (US$M)	Debt Burden to Exports of Goods (%)	Debt Burden to Exports of Goods and Services (%)	Debt Burden to GNP (%)	Interest Payments to GNP (%)
1971	502	422	80	44.2	35.8	6.5	1.0
1972	404	317	87	36.5	27.8	4.8	1.0
1973	432	331	101	22.9	17.1	4.0	0.9
1974	506	385	121	18.6	14.2	3.4	0.8
1975	498	366	132	21.7	15.6	3.2	0.8
1976	858	625	233	33.3	24.9	4.8	1.3
1977	597	n.a.	n.a.	18.9	14.1	2.9	n.a.
1978	893	n.a.	n.a.	26.1	18.2	3.7	n.a.
1979	1,261	634	627	27.4	20.2	4.3	2.1
1980	1,576	600	976	27.2	19.7	4.5	2.8
1981	2,144	769	1,375	37.5	24.9	5.6	3.6
1982	2,930	940	1,990	58.4	36.6	7.4	5.1
1983	2,659	910	1,749	53.1	32.7	7.8	5.1
1984	2,808	693	2,115	52.1	35.0	8.9	6.7
1985	2,921	526	2,395	63.1	36.9	9.1	7.4
1986	2,937	999	1,938	60.6	34.0	9.7	6.4
1987	3,005	1,092	1,913	52.5	32.8	8.8	5.6
1988	2,983	942	2,041	42.2	27.9	7.7	5.3

[1]Data on interest payments and amortization in 1970-76 refer to payments on all fixed-term non-monetary credits (all maturities) plus IMF credits. Data on interest payments and amortization, in 1977 onwards refer to payments on medium- and long-term monetary and non-monetary credits including interest payments on short-term liabilities (including payments on IMF credits and under the rescheduling and new money agreement). No breakdown of debt service burden using the latter definition available for 1977-1978.

n.a. - Not Available.

Source of Basic Data: Central Bank of the Philippines (CBP).

TABLE 4

DEBT AND DEBT SERVICE OF PACIFIC BASIN AND LATIN AMERICAN COUNTRIES, 1986

	Total External Debt (US$ B)	Growth Rate Ext. Debt ('85-'86)	External Debt/ GNP	Debt Service Ratio (to exports of Goods and Services)	Debt Service Ratio (to Exports of Goods)	Per Capita GNP
1. S. Korea	45.1	-5.2	47.4	24.4	30.25	2,370
2. Indonesia	42.1	17.6	58.5	34.9	36.68	490
3. Philippines	28.2	7.6	93.6	34.0	60.66	560
4. India	41.1	12.0	19.1	25.0	36.23	290
5. Malaysia	19.6	6.6	76.2	20.0	23.73	1,830
6. Thailand	17.9	3.1	44.7	26.3	34.90	810
1. Brazil	110.7	3.7	41.0	41.8	47.25	1,810
2. Mexico	101.7	4.7	83.8	51.5	76.37	1,860
3. Argentina	48.9	5.9	65.8	61.8	82.63	2,350
4. Venezuela	33.9	-2.4	70.8	38.5	45.86	2,920
5. Chile	20.7	1.5	138.8	37.1	46.43	1,320
6. Peru	15.3	12.2	62.4	20.5	27.59	1,090
7. Ecuador	8.9	5.2	83.5	33.9	40.62	1,160

Source: World Bank Debt Tables 1987-1988, and World Development Report, 1988.

regressive. The required tax reforms instituted to achieve equity and efficiency may have negative revenue impact. Postponing these reforms or distorting them by additional revenue measures will further aggravate the present inequitable structure.

Taking the first option will, according to the standard line, probably invite retaliation and other dire measures from the creditors. The second and third options will certainly incur the wrath of the populace, and give rise to further economic, social and political instability.

The choice between the probability of external retaliation on the one hand and the certainty of domestic unrest on the other is hardly very attractive.

And since the investment levels must be financed, the only recourse is to seek external cooperation, i.e., foreign savings.

Put in another way: the ability of the economy to use domestic resources to finance the investment levels required to attain its growth target is inversely related to the amount of these resources that flow out to its creditors to service the external debt. This net transfer of resources to creditors (defined as net capital flows minus interest payments) is the major reason why an external financing gap exists. The external financing gap is the amount necessary to ensure a basic balance in the balance of payments: current-account balance plus capital account balance equals external financing gap.

If the Philippines is to achieve its development targets, it must close that gap. Table 5 shows the actual net resource transfers to creditors by the Philippines, which averaged about 4.8% of GNP for the period 1986-1988.

Model Description

The Philippine government is aided in planning and policy formulation by a macroeconometric model.

The analysis is based on an annual macro-econometric model that consists of four major blocks: (1) real, (2) fiscal, (3) financial, and (4) external sector. The core of the model is the real sector block which centers on the determination of output and its expenditure and production components, prices, employment, and wages. The model has 108 equations, 52 of which are identities, and the rest are behavioral equations. Its 54 exogenous variables include major domestic policy instruments (i.e., those directly affecting the budgetary deficit, the current account, debt service, and money supply expansion) as well as the external economy (e.g., export and import prices, output of trading partners).

TABLE 5

PHILIPPINE EXTERNAL DEBT SERVICE BURDEN/
NET RESOURCE TRANSFER TO CREDITORS
1986-1988

	A c t u a l			Actual
	1986	1987	1988	1986-1988
Debt service burden (DSB)				
Total outflows	2,937	3,005	2,983	8,925
Amortization	999	1,092	942	3,033
Interest payments	1,938	1,913	2,041	5,892
Total Inflows	1,710	1,169	1,039	3,918
MLT pipeline[1]	664	425	259	1,348
IMF purchases	275	161	91	527
Identified new money[1]	771	583	689	2,043
Net Resource Transfer	1,227	1,836	1,944	5,007
Percent of GNP	5.6	4.7	5.0	4.9 (Ave.)

[1] MLT pipeline and Identified new money refer to disbursements on loans <u>committed</u> prior to 1986 and 1986 thereafter, respectively. Committed loans are those with signed project or loan documents.

Source of basic data: Central Bank of the Philippines.

III. THE CONVENTIONAL APPROACH TO THE DEBT PROBLEM

Conventional debt strategy pays lip service to the growth approach. The macroeconomic framework in any IMF Memorandum of Economic Policy (MEP) in fact contains the growth "targets" and the levels of investment and savings necessary to achieve them. But the similarity is only skin deep.

Operationally, the IMF staff would have determined the "residual financing required" or financing gap, not residually, but beforehand--in terms of what they expect would be the amount that commercial banks would be willing to lend in "new money." [Since the commercial banks are going to be happiest if there is no new money involved, the amounts are obviously not very large.] To accommodate this level, they then work on reducing S_f, the current account deficit to a minimum (or the current account surplus to a maximum). This in turn implies, from equation (4), that the public sector deficit, which is where the government has direct influence, must be reduced.

But since there is very little flexibility in reducing expenditures when a very large portion, i.e., foreign interest payments, must at all costs be kept up, revenues must somehow be raised. If that fails, then obviously public investment must be reduced. The final result is of course a growth "target" which is actually a residual.

In sum, the conventional approach requires keeping S_f to the barest minimum, but without touching interest payments which show up as outflow in this balance. The items to be manipulated are merchandise exports and imports, which will of course already affect private investment in the domestic sector. Public sector deficits are then amended to accommodate this "given" S_f --and the growth that will in turn accommodate these levels are finally set up as the "target". In the conventional IMF approach, the growth "target" is really a residual, while the "residual" financing required, is in actuality the target.

The tools used to ensure that these levels are adhered to are the ceiling on public sector borrowing requirement (to make sure that the public sector will not borrow more than the indicated deficit levels) and the ceiling on base or reserve money (to make sure that money is not printed).

The Reason for Compliance:

One must restate the reason behind the ultimate docility with which otherwise intelligent governments accept the impositions of conventional debt strategy which is actually a growth-residual approach: The IMF's "seal of good housekeeping" is necessary not only for negotiations with the commercial banks, but also negotiations with creditor governments and the other multilaterals. The loans and disbursements flowing from the latter two form part of the regular capital inflows of the country. Without these flows, the "residual financing" needed would be even larger, and the debtor countries even farther away from financing their development plan--assuming of course, that these countries will faithfully continue to service their debt.

Unfortunately, the link between the IMF negotiations and the commercial bank negotiations is not a one-way link, but a two-way link. Even if the seal of good housekeeping has been awarded, it will be revoked if the debtor country fails to reach agreement with the commercial banks. The latter, knowing this, have tremendous leverage over the debtor countries, who would have to accede to their demands or find themselves without access to official lending. This two-way link effectively creates a creditor cartel against the debtor country.

Attempts to Improve the Conventional Approach

A. The Baker Plan

In late '85, then US Treasury Secretary James Baker proposed the so-called "Baker Plan," which called for greater effort on the part of the creditors to reduce the net transfer problems of debtor countries by more "new money," i.e., debt financing, in tandem with the internal structural adjustments that were being imposed by the Conventional IMF approach. Baker's proposal came on the heels of the announcement by President Alan Garcia of Peru that his country would in effect unilaterally reduce its net resource transfer to creditors by limiting its debt service payments to a percentage of exports. This dramatic announcement highlighted the plight of debtor countries whose attempt to follow the impositions of the conventional debt approach resulted in negligible or even negative growth and therefore tremendous instability. The Baker Plan tried to prevent other similarly situated debtor countries from following Peru's example by holding out hope to them that the conventional debt approach would be leavened by larger amount of "new money."

The Baker plan was a failure, and other countries have, with less attendant publicity, gone into arrears with commercial banks in their resolve to place their obligations to their people ahead of obligations to creditors.

The main reason for the failure of the Baker Plan was that there was no compelling reason for the commercial banks to increase their "new money" lendings, especially since the debtor countries were afraid to go into arrears with them--the two-way link at work.

B. The Brady Plan:

A new initiative was proposed in March 1989 by Treasury Secretary Nicolas Brady. It emphasizes the need for <u>debt reduction</u> rather than just debt financing of "new money." This is a much delayed recognition of the fact that the total international debt stock is too large to ever be repayed in full, a fact which has been recognized in the existence of a secondary market which sells debt paper at varying levels of discount.

Under the Brady plan, which is almost as vague as its predecessor (US Senator Bill Bradley was quoted as having asked, "What are the numbers?"), creditor banks voluntarily agree to reduce the value of their claim in exchange for guarantees on the remaining portion of the debt. The IMF and the WB are to help finance these guarantees. Japan, which earlier had already proposed a debt-reduction scheme but had given the honor of the name to Brady, also has a "Credit-Enhancement Program."

Whether the Brady Plan will work, i.e., whether it succeeds in effectively reducing the net transfers of debtor countries by reducing outflows in amounts which will allow for sustainable growth, is not yet clear.

<u>The Philippine Experience, 1987-1988</u>:

The Philippines experienced a growth rate of 5.7% and 6.7% in real GNP in 1987 and 1988. Unemployment dropped to 9.6% and underemployment to 33%; single-digit inflation levels were maintained; and most important, poverty incidence droppped from 59% to 49.5% in 1988.

Except for the 1987 growth target, which was not attained, the performance of the economy has been as planned. This, however, may have been in spite of, rather than because of, the IMF approach.

During the negotiations for the 1987 IMF standby arrangements, it was determined by the IMF that the residual financing requirements, or the financing gap, for the two years would be zero, i.e., no "new money" would be needed from the commercial banks.

The required accommodation on the part of the Philippines and its effects, took the following form:

(1) To meet the required deficit levels, the national government did not touch the tax structure on petroleum products, nor the import duties on crude oil, both of which were inconsistent with the tax reform measures approved by the government in early 1986. On the other hand, much needed increases in military expenditures (for salaries and supplies), among others, were also ignored. When the international oil prices increased, causing similar movements in domestic petroleum products, a massive transport strike occurred, followed by a coup attempt. The instability caused negative reactions on the part of investors, as well as a run on the peso.

It may be perfect hindsight: but had the government "bitten the bullet" immediately and implemented the tax reforms as well as allowed for a larger public sector deficit, the destabilizing events and its even more destabilizing aftermath might not have occurred. The 5.7% growth rate, instead of the expected 6.5% was the result. As it happened, the government subsequently did lower the duty on crude oil (but has not yet moved to reform the tax structure on petroleum products) and did increase the budget of the military, which lowered revenues and raised expenditure. But this took place after the destabilizing events.

(2) No contingency mechanism was available to allow for divergence of certain exogenous variables from their assumed path. The Philippines was truly on a "tight leash". The financing gap remained zero, indeed, but at a cost in the form of higher interest rates and a running down of international

reserves, which at one point fall to 1.6 months of imports from a high of over 5 months.

Compensating for these were the effects of the other reforms that were being implemented, albeit late. The relatively peaceful labor-management relations, the greater flexibility given to the private sector, and the more cost-efficient government investment expenditures were some of the results of these reforms.

Also remarkable is the fact that the Philippine economy accomplished all these in the face of a net resource outflow to creditors amounting to $ 3.78 billion in the form of net capital outflows and interest payments for 1987-1988. This large outflow in part explains why, compared to countries like Thailand and Malaysia, which posted growth rates of over 10% and 8% respectively, the Philippines did not fare as well.

Growth Before Debt or Debt Before Growth: Philippine-IMF Negotiations for 1989-1992:

The Philippine negotiations for an Extended Fund Facility (EFF) started formally in November, 1988, with the Philippine authorities presenting their planning framework to the IMF (Table 6).

The IMF, on the other hand, suggested (a) a lower growth target of 6%, (b) higher public savings, lower private savings, (c) lower foreign savings, and (d) lower total investments, both public and private.

Table 6
MACROECONOMIC FRAMEWORK: PHILIPPINE AND IMF POSITION
As of November 1988
(% to GNP)

	1989		1990		1991		1992		AVERAGE 1989-92	
	NEDA 1/	IMF	NEDA	IMF	NEDA	IMF	NEDA	IMF	NEDA	IMF
Total Savings	18.8	18.8	21.6	20.9	23.0	21.8	24.2	23.4	22.0	21.3
Foreign Savings (S_p)	2.2	2.1	2.9	2.6	2.9	2.6	3.0	2.6	2.8	2.5
Private Savings (S_p)	15.5	16.0	17.0	16.1	17.6	16.0	18.1	16.6	17.1	16.2
Public Savings (S_g)	1.1	0.7	1.7	2.2	2.5	3.2	3.1	4.2	2.1	2.6
Total Investment (I)	18.7	18.7	21.6	20.9	22.9	21.8	24.2	23.4	21.0	21.2
Public (I_g)	4.1	4.0	5.6	5.0	5.8	5.5	6.0	6.0	5.6	5.1
Private (Ip)	14.6	14.7	16.0	15.9	17.1	16.3	18.2	17.4	16.5	16.1

1/ National Economic and Development Authority-The Philippine planning authority. Items may not add up to total due to rounding

Although the summary tables appear the same, the methods for deriving the government estimates and the IMF figures are not. As mentioned earlier, the former are based on a macroeconometric model that ensures internal consistency with feedback mechanisms from the demand side to the supply side and vice versa. The IMF model, from what could be gathered, uses a simple national income accounting framework with private savings and private investment as the balancing items.

The IMF framework was unacceptable to the Philippine authorities; not only was the lower growth unacceptable, but running the IMF values in the macroeconometric model had shown that these were consistent with an even lower growth rate than the 6% the IMF had indicated. The objections were not limited to the growth targets. The components of these aggregates implied decreases in what were considered vital infrastructure and current expenditures. The negotiations were suspended.

The negotiations were resumed in February 1989 and ended in March, with the Philippine government signing a letter of intent and its accompanying Memorandum of Economic Policy (MEP).

In the MEP, the growth targets of the Philippine development plan were nominally retained. Operationally, however, it would be well-nigh impossible to achieve them. Table 7 tells part of the story.

Even with a higher target, a comparison between the MEP and the initial IMF framework shows that although total savings would have to increase as expected, projected foreign savings are

TABLE 7

COMPARISON BETWEEN THE ORIGINAL IMF[1] FRAMEWORK AND THE MEP[2]
(Percent to GNP)

	1989		1990		1991		1992		Average	
	IMF	MEP	IMF	MEP	IMF	MEP	IMF	MEP	IMF	MEP
<u>Savings</u>										
Total S	<u>18.8</u>	<u>20.5</u>	<u>20.9</u>	<u>22.7</u>	<u>21.8</u>	<u>24.2</u>	<u>23.4</u>	<u>24.7</u>	<u>21.3</u>	<u>23.0</u>
Foreign	2.1	2.2	2.6	2.5	2.6	2.4	2.6	2.2	2.5	2.3
Private	16.0	16.9	16.1	17.2	16.0	17.8	16.6	18.1	16.2	17.5
Public	0.7	1.4	2.2	3.0	3.2	4.0	4.2	4.4	2.6	3.2
<u>Investments</u>										
Total	<u>18.7</u>	<u>20.5</u>	<u>20.9</u>	<u>22.7</u>	<u>21.8</u>	<u>24.2</u>	<u>23.4</u>	<u>24.7</u>	<u>21.3</u>	<u>23.0</u>
Public	4.0	4.2	5.0	4.7	5.5	5.6	6.0	5.8	5.1	5.1
Private	14.7	16.3	15.9	18.0	16.3	18.6	17.4	18.9	16.5	18.0

[1] IMF-suggested framework in November, 1988. The growth rate target was 6.0%, which the Philippine Government rejected.

[2] MEP framework approved in March 1989. Target growth rate was 6.5%.

lower, and this had to be made up for by increases in the savings of the private and public sectors. On the investment side, the increase in total investment is accounted for by private investment. Public investment at a time when infrastructure is badly needed, is actually made to decrease. The increases and decreases are all in terms of percentages to GNP.

The financing gap in the MEP is now at what must be supposed as "financiable" levels, which means, what the commercial banks are willing to lend.

Table 8 shows what the financial gap would have been had a more internally consistent macro framework been adopted and compares it with the financial gap in the MEP. There is a difference of more than $ 1.4 billion between the two estimates over the four-year period, much of which is accounted for in different estimates of the current account balance or S_f. The Philippine authorities will be using the MEP financing gap of $ 1.75 billion for the two years 1989-1990 as the basis of their request for "new money". The planning estimate for the two years is $ 2.1 billion.

Table 9 shows the estimated net resource transfer to creditors for 1989-1992 according to the planning estimate. Note that with indicative inflows, the net resource transfer to official creditors will be reversed by the end of 1992. The country, however, will still be paying out $ 5.9 billion to private banks and financial institutions.

TABLE 8

EXTERNAL FINANCING GAP,
PLANNING ESTIMATES VS. MEP,
1989-1992
(Million US $)

	Planning Estimate	MEP Estimate
Trade	-8,024	-6,490
Non-merchandise (net)	-1,510	-1,726
of with interest payments	-10,326	-10,533
Transfers (net)	3,896	3,896
Current Account	-5,647	-4,320
Medium- and long-term loans (net)[1]	-1,064	-1,064
Direct investment (net)	3,455	3,455
Short-term loans and others (net)	-4,554	-4,554
Capital Account	-2,163	-2,163
External financing gap	-7,810	-6,483
Less: Net indicative flows[2]	3,808	3,891
Equals: External financing gap	-4,002	-2,592

[1] Represents flows from committed loans, i.e., those with signed loan document.

[2] Represents flows from those under negotiations or to be arranged, which are expected, such as OECF loans whose relative magnitudes are known.

TABLE 9

ESTIMATED NET RESOURCVE TRANSFERS TO CREDITORS
1989-1992*
(Million US $)

A. Credit Source	Committed [1]	+ Indicative [2]	= Total
Official	3,167	-3,808	-641
Bilateral	1,133	-1,977	-844
Multilateral	2,034	-1,831	203
Banks and FIs	5,970	-	5,970
Others	989	-	989
Total	10,126	-3,808	6,318

*Planning estimates; negative figures mean inflow, positive mean outflow.

[1] Represents flows from committed loans, i.e., those with signed loan document.

[2] Represents flows from those under negotiations to be arranged, which are expected, such as OECF loans whose relative magnitudes are known.

There are several shortcomings of the MEP, as brought out in a technical assessment of the document by the NEDA. The more glaring ones are:

(1) internal inconsistencies: inflation rates are too low, resulting in very stringent monetary and fiscal targets, which would likely lead to lower growth and higher unemployment than is targetted in the medium-term plan.

(a) The inflation rates, year-on-year, for January and February 1989 are already 9.0 and 8.9% respectively. It is unlikely that a low 8% for the whole year can be attained, given expected increases in oil product prices, the minimum wage, tuition fees, power rates, and interest rates.

(b) High export targets and low import targets which are inconsistent with the postponement of the trade reform program and the sluggish pace of peso depreciation assumed in the MEP.

(2) unrealistic fiscal target and stringent monetary targets.

(a) Public savings are expected to increase from only 0.6% of GNP in 1988 to 1.4% in 1989 to 3% in 1990. Most of these will be borne by the national government, whose deficit is expected to decrease from 3.1% of GNP in 1988, to 1.6% in 1989, to 0.4% in 1990 and 0.007% in 1991. Ironically the sources of the revenue increases have not yet even been identified.

(b) The monetary base and net domestic assets are lower than what can be expected based on seasonality and historical growth.

(3) inconsistency with existing policies, which are contravened by some MEP provisions.

There is a GATT provision allows LDCs to institute trade barriers barriers for balance of payments reasons. The MEP states that the government will refrain from doing so.

The logical question that can be asked is why a Memorandum of Economic Policy, which effectively mocks of the Philippine Medium-term Plan, was signed by the Philippine authorities. Three reasons have been given by the proponents of this policy.

(1) The first reason given was that there was no difference between what was contained in the MEP and the Development Plan. The evidence given for the assertion was the fact that target levels for growth were the same for both. That the IMF gave in to the authorities' insistence on a 6.5% average growth rate target was even considered a victory.

(2) The second reason was that time was of the essence, as it always seems to have been. The Philippines was already in arrears with the Paris Club, and without the agreement, suspensions of loan disbursements would follow. It was not explained why the country was in arrears to official creditors who were granting new loans rather than to the private

commercial banks, from whom no "new money" loans had been forthcoming.

(3) The third and major reason, which had also been used very effectively to convince the government to sign the U.S. military bases review agreement, was that unless the MEP was signed, the Philippine Assistance Program (which will be discussed below), supposedly a mini-Marshall Plan for the Philippines, could not progress. The latter, it was thought, would provide more than enough to cover the financing gap. And the MEP signing would be the key to progress of this PAP.

IV. PHILIPPINE PROSPECTS FOR 1989-1992

A. Under the Conventional Debt Strategy

It would seem that the Philippines' reward for excellent economic performance and implementing structure reforms is to be placed on an even tighter leash than it was with the 1987 IMF standby arrangement. The target ceilings on National government deficit and public sector borrowing requirement (PSBR); the targetted growth of net domestic assets, monetary base and broad money; the small financing gap estimates which are to be the bases of the negotiations with the commercial banks for "new money"; these, together, have removed all flexibility from the government in its efforts to achieve its growth and equity targets. The IMF program is unrealistically harsh on the Filipino people, and reflects the priorities of the private creditors rather than the realities of economic adjustment. Under the conditions imposed by conventional debt strategy, the Philippines most certainly will not grow at a rate that will allow the race against social and political unrest to be won, nor will it grow at a rate that will increase substantially its capacity to pay its obligations.

B. The Role of Debt Conversion Schemes

Since 1982, a secondary market for debt paper of highly indebted countries held by private creditors has emerged. Debtor governments are not allowed to be direct buyers of this paper under the terms of current debt restructuring agreements.

However, several schemes have been formulated so that they can benefit indirectly. THe result would be a reduction in net transfers through reducing outflows.

The Philippine government in August 1986, adopted a program for the conversion of debt into equity investments. Since then, several other debt conversion schemes, such as debt-for-debt, debt-for-asset, and debt-for-nature, have been also instituted. The debt-equity program has by far been the largest, as shown by Table 10.

There seems to be a great deal of enthusiasm, particularly on the part of foreign creditors and financial institutions, for the continuation of this program. This is understandable, from their point of view. First, to the extent that demand for that debt paper increases, its market price increases, i.e., the discount at which the debt paper sells goes down, and their revenues increase (or losses decrease).

Since under the Brady Plan the secondary market discounts will be used for negotiations based on debt-reduction schemes, the higher (lower) the market price (discount rate), the better off they are vis-a-vis the debtor countries who will benefit from any direct debt-reduction exercise. Finally, the fees from brokering the purchase transactions simply constitute an addition in income.

Enthusiasm is also great on the part of the potential investors. Under the present rules of Central Bank Circular 1111, which governs the debt equity conversions, investors enjoy

Table 10
DEBT REDUCTION UNDER VARIOUS SCHEMES
1986-1988
(In Million US Dollars)

SCHEME	1986	1987	1988	TOTAL
1. Debt to Equity Conversion 1/	15	267	342	724
2. Debt for Asset Swap	--	---	109	109
3. Debt for Debt Swap	--	3	12	15
4. Debt for Nature			0.4	0.4
Total	15	270	463.4	848.4

1/ Excludes $137 million debt converted to equity for which investment is temporarily placed in CB bills.

Source: Central Bank of the Philippines

exchange rate premiums or bonuses of as high as 100%, for a 70% discount (see Table 11). In effect, the debtor country subsidizes foreign investors.

Reasons for enthusiasm on the part of the Philippines seem more elusive, however.

First, most of the paper traded represent obligations of the Central Bank, as shown in Table 12. That entity's buy-back of the debt will represent either an addition to reserve money, if it is paid in currency, or it will constitute an upward pressure on interest rate, if it is paid through issuance of central bank bills. Table 13 shows the effect on reserve money of the debt to equity conversion program. The 1988 reserve money increase of ₱ 5.5 billion is equivalent to more than 50% of the targetted increase in reserve money for the year, per previous IMF agreement.

Given the stringent monetary targets under the IMF program, keeping within the ceilings will require adjustments elsewhere. The upward pressure on interest rates as a result of issuing CB bills not only discourages other private investment, but also increases interest expenditures of the public sector. To keep within the deficit ceilings (also imposed by the IMF) may therefore require reductions in other current expenditures or in public investment expenditures. It may well be that any foreign investment brought in through these schemes may be nullified or even overborne by the decrease in domestic investment.

TABLE 11

EXCHANGE RATE PREMIA FOR INVESTORS, DEBT REDUCTION AND FRESH MONEY INFUSIONS, AT DIFFERENT SECONDARY MARKET DISCOUNTS, FOR PRIORITY (SCHEDULE 2) INVESTMENTS [1]

	Fresh Money (% of Investment)	Conversion Fees (% of Face Value)	Secondary Market Discounts (% of Face Value) 20	30	40	50	60	70
Original CB 1111	0	5	18	33	54	82	122	185
Debt reduction [2] $ 100								
Forex infusion [2] $ 5								
Revised CB 1111 [3]								
Debt reduction [2] $ 50	50	0	11	18	25	33	43	54
Forex infusion [2] $ 50								
Debt reduction [2] $ 60	40	6.7	9	16	25	35	47	61
Forex infusion [2] $ 44								
Debt reduction [2] $ 70	30	11.5	6	15	25	37	51	69
Forex infusion [2] $ 38								
Debt reduction [2] $ 80	20	15.1	4	14	25	39	56	78
Forex infusion [2] $ 32								
Debt reduction [2] $ 90	10	18.0	2	12	25	40	61	88
Forex infusion [2] $ 26								
Debt reduction [2] $ 100	0	20	0	11	25	43	67	100
Forex infusion [2] $ 20								

[1] Calculated as follows: f = % age of investment required as fresh money; c = conversion fee as % age of face value of debt paper; and d = discount of debt paper.

[2] Under the revised rules, the investor has a choice among different combinations of fresh money, infusions and conversion fees.

[3] Per $ 100 of investment cost. Exchange Rate Premium (%) = $1/f + (1 - d)(1 - f) + c(1 - f) - 1 \times 100$.

TABLE 12

DEBT-EQUITY CONVERSION TRANSACTIONS
BY TYPE OF DEBT PAPER, AND INVESTOR
1986-1988
(In Million $)

		Type of Debt Paper				Type of Investor	
Period	Transactions	CB	Non-bank		Fresh Money Infusion	Resident	Non-resid[illegible]
1986	15.2	12.2	3.0		0.0	0.9	14.3
1987	266.4	248.8	17.6		0.0	100.1	166.3
1988	479.2	368.1	87.9		23.2	194.2	285.0
Total	760.8 =	629.1 +	108.5	+	23.2 =	295.2 +	465.6

Source: Central Bank.

Table 13
IMPACT OF DEBT-EQUITY CONVERSION SCHEME
ON NEW MONEY, 1986-1988
(In Million Pesos)

	Amount Closed (in US$m) 1/	Phil. Peso Equi- valent	Without RM Impact 2/	With RM Impact: Conversion of CB Debt Papers	With RM Impact: Fresh Money	Contractionary Factors: Special Series CB Bills Issued	Contractionary Factors: Conver- sion tran. fee 3/	Expansionary Factor: Redemptions of CB Bills	Net Immediate RM Impact 4/	Build-up (-)/ Withdrawal (+) in Special Account with CB-Proceeds of Transferred/ Sequestered Assets 5/	Net Subsequent RM Impact 6/
1986	15.227	311.483	27.236	284.247	--	--	- 19.172	--	265.075	--	265.075
1987	266.441	5499.420	353.766	5145.654	--	-1062.814	-263.359	481.014	4300.495	-323.600	3979.712
1988 p/	479.018	10069.487	1883.846	7735.854 a/	487.637	-10443.10 c/	-231.497	7644.200	5155.244	313.599	5468.843

1/ Includes closed transactions which have not been invested in any Philippine enterprise but which were temporarily placed in CB bills per MB Resolution No. 1245 dated December 11, 1987.
2/ Involves non-CB debt papers
3/ Refers to conversion transaction fee which are credited to the NG's account with CB, payments of which are deducted from or netted out of the conversion proceeds, or which are paid directly by the investor to the CB for the account of the National Government.
4/ Reflects portion of conversion proceeds credited to the demand deposit account of commercial banks where Philippine firm maintains its account.
5/ Conversion proceeds of Asset Privatization Trust (APT) assets are remitted directly by the APT to the National Government who in turn deposits these funds in a Special Account with CB named Proceeds of Transferred/Sequestered Assets by GFIs/PCGC*, proceeds of which are earmarked for CARP beneficiaries. Figures refer to the difference between the monthly outstanding balances in the said Special Account.
6/ The net subsequent impact on RM is arrived at by adding the build-up/withdrawal in the Special Account to the net immediate impact on RM.

a/ Includes portions of applications which were funded through fresh money infusion aggregating US$23.146 million as of end-December 1988.
b/ Preliminary
c/ Revised

In addition, it must be emphasized that although the country's debt to foreign banks may have been reduced, its local debts increase by almost the same amount. And since the latter carry much higher interest rates, the burden on public sector current expenditures may be much higher.

Second, only a nominal portion of investment inflows so far under the debt equity swap constitute additionality, i.e., investments which would not have taken place without the scheme. At most, the arrangement may have hastened the timing of decisions already made to invest.

Third, even if there is additionality, there is no increase in foreign exchange available to help absorb inreased demand in the medium-term. The savings in foreign interest payments are not sufficient to overcome these effective reductions in foreign exchange availability.

Fourth, to the extent that resident investors are allowed to participate, there will be a decrease in foreign exchange reserves, or there will be an upward pressure on foreign exchange rates, which again will impact on the public sector deficits, as local currency costs of servicing the foreign debt rise.

Fifth, the additional burden of administering these schemes, to minimize their costs or maximize their effectiveness, could have very well been concentrated on solving other structural problems of the economy. This, by the way, is also one of the biggest costs of these yearly or bi-yearly negotiations with foreign creditors.

After all is said and done, therefore, these debt conversion schemes, from the point of view of the Philippines, represent at their very best minimal net benefits to the country. And in the medium-term, 1989-1992, their net effects on the country's balance of payments are definitely negative.*

C. The Role of the Multilateral Assistance Initiative

As early as November 1986, the Philippine government had already sent out feelers to Japan, asking them to launch a "Philippine Initiative," by April, 1987 the elements of which of were the following:

(1) a commitment by Japan to extend a substantial amount of official development assistance to the Philippines in the next 5-6 years, consistent with the requirements of the Philippine Development Plan for 1987-1992;

(2) expressed willingness of Japan to take the lead in mobilizing foreign assistance from other creditor governments and multilateral institutions;

(3) initiative to be taken by Japan to organize a high

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* The monetary authorities suspended all new applications under the debt equity conversion scheme since February 1988. The Cb requested the World Bank to send a mission to analyze the program as well as some potential implications of continuing it. The report has been submitted but has not yet been discussed.

level standing committee on the Philippines, to be chaired by Japan and composed of representatives of major industrial countries and multilateral institutions; and

(4) encouragement by Japan to its business community to take an active part in our growth efforts.

Japan may not have felt ready to assume such a conspicuous role in this effort which would essentially lead to the formation of an Inter-governmental Group for the Philippines (IGGP), similar to the special groups established in the 60s and 70s for Indonesia and Turkey, which proved to be decisive for the successful economic recovery of those countries. At any rate, the initiative came to naught.

A year later, a bipartisan group of American senators and congressmen wrote President Reagan urging for a special effort patterned after the European Marshall Plan, because ..."We believe the Philippines is now at a critical juncture, with the future of democracy in that country hanging in the balance... (this) net transfer of capital out of the country is a significant impediment to a sustained economic recovery..." The crux of their proposal was $ 5 billion in additional official development assistance, above and beyond normal flows from the international "donor" community. This plan, called the Solarz Plan in the Philippines, called for a consortium composed of the US, Japan, the EEC, Australia and the World Bank.

In May of 1988, almost coinciding with the start of Philippine-US Military Bases review, newspapers carried banner headlines divulging a $ 10 billion five-year Multilateral Assistance Initiative being pushed by the United States, and again likened to the Marshall Plan. [Two days later, a US state department spokesman was quoted as saying it was premature to talk about the money involved, but the figure has stuck in everyone's minds].

The Philippines took the news seriously, despite private warnings from the other countries that were supposed to be involved: first, they did not like the term Mini-Marshall Plan, because it implied that the United States would be the largest contributor, although it was obviously not in a financial position for such a role; and second, they also warned that they themselves would not be in any position to increase their aid amounts to the levels being bandied about.

The government constituted a task force in June 1988 to prepare the groundwork for a Preparatory Committee composed of high-level representatives of the different countries, who would in turn suggest members of a Wisemen's Group (Japan's suggestion) of distinguished international private sector figures. It was hoped that either an IGGI type of organization would evolve, or at the very least a group headed by the Asian Development Bank, so that a clear distinction could be drawn between this and an existing Consultative Group for the Philippines headed by the World Bank. This distinction would ensure that the "incremental" or "special" characteristics of the Multilateral Assistance Initiative would not be confused with the normal aid flows.

The first meeting of the Preparatory Committee was scheduled for August 1988.

It seems that this burst of initiative from the Philippine side was not appreciated. Subsequent events, all from the "donors'" side

(a) postponed the meeting of the Preparatory Committee

(b) dismissed the idea of a Preparatory Committee altogether

(c) dismissed the idea of a Wisemen's Group

(d) questioned the "absorptive capacity" of the Philippines to absorb additional aid*

(e) dismissed the concept of an IGGI-type mechanism, and talked about an "energized" consultative group, an "enhanced" consultative group, an "enlarged" consultative group, and finally, as per the Tokyo meeting, just the "consultative group for the Philippines" chaired by the World Bank.

(f) declared the idea of a "special" or "incremental" program as unviable.

There was confusion in the minds of the Filipinos, however, because of repeated reports on US moves towards a Multilateral Assistance Initiative.

In short, although the MAI/PAP, through time, had been

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* This obviously was a red herring. The World Bank, at the Consultative Group meeting in Tokyo early in July, stated that the Philippines was "not the best performer but not the poorest either." In fact, the Philippines, in terms of its availment rate for foreign assisted projects, is better than most of its Asian neighbors.

distorted out of all recognition from its original concept, the name stayed on, and so most people, both foreign and Filipino were deceived into thinking that a Marshall-Plan aid program was in the works.

In the meantime, on the basis of the original carrot, and the stick waved that this special program for the Philippines would be jeopardized by protracted negotiations, the Philippine government signed military bases review agreement with the United States in November 1988.

Thus, the promise of a Multilateral Assistance Initiative-cum-Philippine Assistance-cum Mini-Marshall Plan facilitated not only the hasty signing of an agreement with the United States which many quarters consider inadequate, if not unfavorable because of new conditionalities, but also the hasty signing of the Memorandum of Economic Policy with the IMF, which is even more unfavorable to the Philippines.

The Philippines has clearly already made large sacrifices in the hope of getting this "special" treatment. What were the results of the Consultative Group meeting in Tokyo in early July 1989 ? The World Bank reported that pledges of aid totalling $ 3.5 billion had been made for 1989. This was immediately taken to mean success for the MAI/PAP.

What is important, however, is to clear up the confusion. As a pledging session, the Tokyo affair was definitely a success. But then, no pledging session of a Consultative Group meeting has ever been called a failure. The more basic issue is whether these pledges represent resource flows into the Philippines that were above and beyond expected levels, and were not already taken into account in estimating the financing gap of the country by the IMF and the Philippine authorities. Stated in another way, what is the reduction in the financing gap that will take place as a result of the Tokyo pledging session?

Table 14 shows the result of an analysis of the pledges made in Tokyo as against expected pledges of regular ODA as of June 30, 1989 resulting from discussions which started in 1988 or even earlier. The methodology used for determining "additionality" is really quite simple: Expected pledges were estimated based on regular discussions on country lending or aid programs from each regular source. These were then compared with the actual pledges in Tokyo. If Tokyo pledges were greater, the difference was attributed to the MAI: if less, (as actually did happen for some sources), the original estimates were lowered, so that there would be no deductions from what was attributable to the MAI. Countries and institutions such as WB, ADB and Japan for example, are not included because what they announced in Tokyo was, in fact, already inputted in estimating the financing gap under the MEP to the IMF.

The table shows that the "additionality" represented by the Tokyo pledges amounted to $ 251.3 million for 1989, of which $ 200 million comes from the United States, and $ 986 million for

TABLE 14

SUMMARY TABLE: PAP/TOKYO ADDITIONAL ODA PLEDGES[1]
(Amount in US$ Million)

Donor	1989	1990	1991	1992	1993	Total
US	200.00	200.00	200.00	200.00	200.00	1,000.00
Netherlands	6.64					6.64
Germany	27.63					27.63
Korea		0.45				0.45
EEC	5.46	5.46	5.46	5.46		21.84
Spain	8.36	8.36	8.36	8.36		33.44
France	3.22	31.00	31.00	31.00		96.22
Total	251.31	245.27	244.82	244.82	200.00	1,186.22

[1] Over and above expected regular ODA pledges.

Source: Estimates as of July 23, 1989.

CORRESPONDING ESTIMATED INFLOWS FROM PAP LOAN AND GRANT DISBURSEMENTS
(Million US$)

	1989	1990	1991	1992	Total
Loans	0.0	0.3	2.9	7.6	10.8
Grants	72.8	147.7	216.2	213.6	650.3
of which U.S.	66.7	133.3	200.0	200.0	600.0
Total	72.8	148.0	219.1	221.2	661.1

the four-year period 1989-1992, of which $ 800 million is expected from the United States (these amounts still have to be approved by the U.S. Congress). This is a far cry from the Solarz plan which calls for $ 1 billion a year or the Multilateral Assistance Initiative (or Philippine Aid Plan) which calls for $ 2 billion a year, half of which is supposed to be official and the other half private. (How one can calculate private sector flows attributable to the MEI/PAP has not quite been resolved.)

But pledges do not represent cash flows. They have to be "committed", i.e. translated into signed loans or grant documents, and then disbursed over time. The expected inflow of the "additionalities" is $ 72.8 million in 1989 and $ 661 million over the four-year period. These would constitute a reduction of about 15 % of the financing gap (planning estimate).

Given the magnitudes cited above, it does not look like the results of the MAI/PAP represent a substantial step towards closing of the financing gap if the Philippines is to achieve its growth and equity targets.

It should be noted that, in the Tokyo pledging sessions, part of the publicized $ 3.5 billion is $ 600 million from the Ex-Im Bank of Japan which is not normally considered ODA. This is part of Japan's Credit Enhancement Program consistent with the Brady Plan for debt reduction. Its impact on closing the 1989-1990 financing gap though reduced outflows will depend on the conditions and timing of its use, and on the conditions of the comercial banks who hold the debt paper. There are no firm indications on either of the above.

V. SUMMARY AND CONCLUSIONS

Except by sheer coincidence, as in the case of savings and investment decisirns, the growth rates needed by the highly-indebted developing countries for broad-based sustainable growth and those resulting from an IMF/conventional approach are not going to be the same. Unfortunately, the latter growth rate, which is the lower, will prevail. One merely has to look at the experience of the past seven years to know how this result has immiserized the hundreds of millions of people, created all kinds of social and political unrest, and jeopardized peaceful international relations.

And yet, the result persists.

One can understand, although not necessarily sympathize with, the reasons why the approach was taken in the first place. Priority was explicitly accorded to preventing a collapse of international banks and financial institutions, over the collapse of national economies.

But now that the danger is long past, the rationale behind the former approach is no longer valid.

And yet, it goes on.

The Brady Plan is being hailed as the key to the long-term solution of the international debt problem: debt reduction, as opposed to debt financing, which was the vehicle of the Baker Plan, in order to reduce the net resource transfer to creditors.

The former works through reducing the outflows, the latter through increasing the inflows. Both plans, of course, recognize the need for internal structural adjustments in the debtor countries in order to assure efficiency and equity in the use and distribution of the resources made available.

There is no question that debt reduction is long overdue. It is superior to debt financing as far as the debtor countries is concerned because it reduces the debt stock which must be paid in the future.

But the element which led to the failure of the Baker Plan is still in place, and will just as surely cause the failure of the Brady Plan: that is, the current negotiating process which allows the commercial banks far greater leverage over debtor countries than they would have under normal circumstances. Conversely, the current negotiating process denies the debtor countries the leverage they would normally be exercising against the commercial banks.

The case of the Philippines is instructive: for the period 1989-1992, the country will be paying out $ 6 billion to the private creditors. Normally it should be easy for the country to do so because it then has the confidence to ask, and be assured of receiving a new loan of $ 4 billion to close the financing gap, because there will be on the part of the bankers the fear that if the $4 billion is not lent, then the $ 6 billion won't be paid in the first place.

Instead, it appears that the Philippines may have approached the negotiating table in fear and trepidation. Because in the current negotiating process, if no agreement with the commercial banks takes place, the IMF agreement is suspended, and the official creditors, bilateral and multilateral, also suspend their lending activities to the country.

With such a comfortable interlinked deal going for the lending institutions, it is no wonder that the banks did not pay any attention to Mr. Baker when he asked for their participation in the initiative. Nor will they pay attention to Brady.

If we truly want to give the Philippines and other debtor countries an even chance to achieve their objective of broad-based, sustainable growth, there is no need for any legislation, regulation, nor otherwise for strong-arming the commercial banks to participate in any debt reduction exercise. Their cooperation is assured so long as the creditor governments follow their own prescriptions: that is--break up cartels, and allow competition and market forces to operate free--this can be achieved by delinking the current negotiating processes from each other.