

STATE OF THE NATION REPORTS

THE RECORD OF A NON-CONFRONTATIONAL DEBT MANAGEMENT APPROACH

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UNIVERSITY OF THE PHILIPPINES
Center for Integrative and
Development Studies
and

University of the Philippines Press

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ISBN no. 9718797-00-14

1992 MAY

FOREWORD

The State of the Nation Reports are condensed and popular versions of studies produced under the UP Assessments on the State of the Nation: A Multi-Disciplinary Research and Outreach Program. By making these scholarly studies accessible to the public, the University of the Philippines Center for Integrative and Development Studies (UP-CIDS) hopes to contribute to the continuing debate on the nation's future and the alternatives for shaping it.

Part of the popular discontent with the Marcos regime was the enormous foreign debt that it has acquired in the name of the Filipino people. At the end of its tenure, it is worthwhile to evaluate the Aquino administration's handling of the debt issue. This State of the Nation Report by A. M. Mendoza, Jr. examines the record of Aquino's non-confrontational approach to managing our foreign debt. Amado Mendoza, Jr. is Assistant Professor in Social Sciences at the College of Arts and Sciences, UP Manila. He has published numerous papers on the Philippine foreign debt and is editor of *Debts of Dishonor (Quezon City: Philippine Rural Reconstruction Movement, 1991)*. An academic who is also a political activist, Prof. Mendoza was Vice-President of Freedom from Debt Coalition from 1988 to 1990.

Prof. Ruperto P. Alonzo of the UP School of Economics, Prof. Leonor M. Briones of the U.P. College of Public Administration, and Dr. Jose Dalisay, Jr. of the U.P. Department of English and Comparative Literature helped prepare this report for publication.

A grant from the Ford Foundation to the University of the Philippines enabled the UP Center for Integrative and Development Studies to publish the State of the Nation Reports.

Finally, the assessments and recommendations published in this series are solely those of the authors whose academic freedom is held sacred in the University and guaranteed by the Constitution.

Emmanuel C. Lallana
General Editor

Even as the government of President Corazon C. Aquino is on its way out, it has enacted several controversial initiatives on the foreign debt front. These included an out-of-court settlement with Westinghouse, supplier of the controversial Bataan nuclear power plant, and a third commercial loan package that is to be finalized by mid-April this year. Finance and monetary authorities have defended these moves as necessary in order to afford the incoming administration a better basis for further economic progress. Critics from various quarters, on the other hand, have raised the dangers of limited options for the incoming government and legitimization of fraudulent loan transactions, among others. Aside from resurrecting previous controversy about the nuclear plant's safety and overpricing, the settlement with Westinghouse also raised questions about profits earned by people dealing in the secondary market for debt paper armed with "insider" information.

With these developments cropping up during the campaign period, the Aquino government's management of the country's foreign debt may yet become a key issue in the 1992 elections.

THE MARCOS LEGACY

Any serious consideration of how the Aquino government has handled the country's external debt should start with an examination of the Marcos record. After all, most of this debt was contracted during the two decades of the Marcos dictatorship. There is widespread recognition among the Filipino people that a significant portion of these loans did not contribute to the country's development or to the people's welfare, and that much of the money was spirited away by the Marcoses and their favored friends.

Our external debt as of end-1986 (at \$28.2 billion) represented 47 times that of 1965, the last year of the Macapagal administration. While foreign indebtedness grew by an annual average of \$332.3 million during the first five years of Marcos rule, it ballooned to \$2,710.3 million during the last five years of his dictatorship. The Marcos regime was likewise responsible for enlarging government's share of the external indebtedness. In 1965, the public external debt stood at only \$359 million. By 17 October 1983, when the dictatorship announced it was seeking a debt rescheduling/restructuring and a payments moratorium, public external debt had expanded to \$15 billion. Since then, the country's creditors have compelled the Philippine government to guarantee private external debts. Subsequently, the government had to assume these government-guaranteed obligations as the private debtors either went bankrupt or skipped the country to settle into well-prepared egg-nests abroad.

The rise in external debt stock was followed by an increasingly heavier debt payments burden. During the 1970-1975 period, total debt service (*interest and principal payments*) ate up from 75% to 90% of our export earnings. In 1980, our export earnings could not cover total debt services forcing the Marcos government's statisticians to tamper with the debt-service ratio to comply with a legal 20% limit. Interest payments alone accounted for much of the increase, claiming 11% of export revenues in 1970 and 49 percent in 1985.

The assassination of Benigno Aquino precipitated a crisis which crippled the ability of the country to service its external debts. Following the October 1983 moratorium, the Marcos government had to negotiate with its creditors, beginning with the IMF. The finalization of the standby arrangement with the IMF took a while as the latter pressured the Marcos regime to adopt reforms such as devaluing the peso and dismantling the crony-controlled monopolies in sugar and coconut. Other interested parties, the US government particularly, exerted pressure on its own for power-sharing arrangements with the regime's parliamentary opposition.

After securing the IMF accord, agreements with the Paris Club and the commercial banks were forged in 1984 and 1985, respectively. These agreements involved \$1.01 billion in officially-sourced debts and \$5.55 billion in commercial debts. In exchange for stretching the payment of the commercial debts due from October 1983 to December 1986 over a ten-year period (with a five-year grace period), the banks charged a higher premium of 1 and 5/8 percent on the restructured loans. The commercial banks also granted a \$3.0 billion trade facility and \$925 million in new loans (*or the so-called new money facility*). In addition, the banks also compelled the Marcos government to assume the external debts of private firms (*most of them owned or controlled by the Marcoses or their cronies*), including those of the Asian Reliability Company, Inc. (ARCI).

The Paris Club covered loans maturing from January 1985 to June 1986. Payments for all of the loan principal and 60% of interest due were extended to ten years, with a five-year grace period.

Rescheduling with the Paris Club and commercial banks was possible only after the Marcos government agreed to adopt an IMF-prescribed "economic recovery program." More accurately, it was a "debt repayment program" which committed at least 50% of the country's annual export revenues (or about \$2.4 billion per year) to servicing interest payments alone. The priority given to debt repayment was the principal factor for the 1984-1985 recession—the country's worst post-war economic crisis.

Thus, even before Cory's assumption to power, the stark competition between the country's external debt payments and its internal requirements for economic growth had been laid bare. It also underscored the impact of economic difficulties on the country's political course.

TABLE I
CHANGES IN THE FOREIGN DEBT PROFILE

<i>PARTICULARS</i>	<i>1985</i>	<i>1991</i>
1. FOREIGN EXCHANGE LIABILITIES (IN BILLION \$)	26.30	29.422
2. DISTRIBUTION (%)		
A.BY DEBTOR		
PUBLIC	73.0	81.0
PRIVATE	27.0	19.0
B.BY CREDITOR		
(i) OFFICIAL	28.0	52.8
BILATERAL	11.0	31.2
MULTILATERAL	17.0	21.6
(ii) COMMERCIAL	58.0	37.5
(iii) OTHERS	14.0	9.7
C.BY MATURITY		
SHORT-TERM	33.0	16.3
MEDIUM & LONG-TERM	67.0	83.7
3. DEBT SERVICE RATIO (%)	58.0	31.0
4. DEBT-TO-GNP RATIO (%)	82.0	65.0
5. DEBT-TO-EXPORT RATIO (%)	357.0	219.0

All figures as of end-October 1991, except debt-service, debt-to-GNP and debt-to-export ratios which are end-July figures.

Source: Central Bank

THE DEBT NUMBERS DURING THE AQUINO WATCH

To put things in perspective, it would be instructive to get some of the numbers up front. As things stand, the Philippines belongs to the "elite" ranks of the world's top 10 debtors. It is the only Asian country which had experienced a foreign debt crisis despite the fact that South Korea (with \$45.1 billion) and Indonesia (with \$42 billion) have larger foreign debt liabilities. Perhaps it is only proper that the only Latin country in the Orient be afflicted with the Latin American "disease," the Third World debt crisis of the 1980s which started with the Mexican crisis of 1982.

The Aquino government inherited some \$26.3 billion (as of end-1985) in foreign obligations from the Marcos regime. Total foreign obligations increased (on a net basis) by \$3.1 billion to reach \$29.4 billion by October 1991. Of this total, \$24.6 billion, or 84%, were medium and long-term obligations while only \$4.8 billion were short-term debts.

One could also classify the debt by source. Multilateral creditors like the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (or World Bank), and the Asian Development Bank (ADB) provided \$6.4 billion, or 21.6%. Bilateral creditors, such as the US government and the Japan Export-Import Bank, accounted for \$9.2 billion, or 31.2%. Private commercial banks and financial institutions remain the largest single credit source, with an \$11.08 billion, or 37.5%, contribution. Other lenders contributed a total of \$2.8 billion.

The profile of creditors by source changed during the period under review. In 1985, commercial banks accounted for the lion's share of credits extended to the country at 58%, exceeding even the combined lending of multilateral and bilateral lenders (28%). By October 1991, the combined lending of public institutions amounted to 52.8% of total outstanding credits.

Aquino's financial managers attribute the increase in total foreign debt stock since 1985 to several reasons, including foreign exchange fluctuations (\$2.566 billion), new loans (\$4.152 billion), and capitalization of interest due on bilateral credits from the so-called Paris Club of creditors (\$737 million). The gross increase in foreign debt stock was offset by various debt reduction schemes (\$3.803 billion), assignment of credits to locally-based foreign currency deposit units or FCDUs (\$321 million) and adjustments including repayment and cancellation of official development assistance (ODA) credits (\$804 million). It is obvious that the offsetting factors were not enough to prevent the increase of the total foreign debt stock during the Aquino watch.

Other numbers suggest improvements on the debt front. The current debt stock is reportedly more manageable as it is lower relative to the country's capacity to pay. In 1985, it took 82% of the country's gross national product (GNP) to pay off our debts. By July 1991, the debt-to-GNP ratio was only 65%. The debt-service ratio (or the ratio between total debt service payments and export revenues) fell from 58% to 31% during the same period. Likewise, the debt-to-exports ratio was down to 219% from 357% in 1985.

To the ordinary person, however, these improved numbers may not make any sense. Furthermore, the increase in the foreign debt since 1986 is made even more incomprehensible by the huge amount of net foreign exchange outflows during the same period. Critics of the Aquino government's debt management policy argue that a net inflow of foreign exchange is the single most important measure of the soundness of any debt program. Central Bank data indicate that from 1986 to September 1991, the country sustained a net foreign exchange outflow of \$7.856 billion or an average of \$1.506 billion yearly.

This means we paid our creditors \$7.856 billion more than what we received from them in total loans during the Aquino watch. But total foreign debt stock still increased by \$3.1 billion over the same period. How come?

The answer to this seeming puzzle lies in the nature of these foreign exchange outflows. One should consider the shares of principal and interest payments, respectively, in total debt service payments. The large payments made on the debt during the Aquino administration did not make a dent in total debt stock because most of these were payments on interest. Across the board, principal payments had consistently been lower than principal availments; net principal inflows amounted to \$4,619 million from 1986 to September 1991.

On the other hand, interest payments to all creditors amounted to a more substantial \$12,475 million. Thus the overall negative foreign exchange outflow. Of the total net resource transfer, 75.7% or \$6,199 million flowed into the coffers of private commercial banks; 21.3% or \$1,651 million to multilateral creditors; and 16.97% or \$1,289 million to other creditors. Only bilateral lenders poured in more than what they received in principal and interest repayments — a net of \$1,687 million during the period.

So while the commercial banks managed to lower their collective loan exposure to the country over the period, they similarly managed to capture the lion's share of net resource transfer.

The shift in the debt burden to the public sector (which is indicated by the increase of public debtor share of the country's total foreign exchange liabilities from 73% in 1985 to 81% in October 1991) will exact its toll on the country's public finances. Appropriations for debt service payments will consistently eat a substantial portion of the Aquino budgets. Of the 1987 budget of P160 billion, a total of P75.2 billion or 47 percent was allocated for debt service. Of the total debt service allocation in 1987, P49.7 billion serviced public external debt while the remaining P25.5 billion went to public domestic debt.

The 1988 budget was the first to be passed under the 1987 Constitution which restored legislative control over public funds. Nevertheless, a Marcos decree, PD 1177 (or the so-called Budget Reform Act of 1977) remained in force and provided for the automatic appropriation of debt service payments and national government guarantees of obligations which are being drawn upon or have matured. A total of P69.2 billion was automatically appropriated for these purposes without the benefit of congressional scrutiny or debate. By this time, the allocation for domestic debt payments, at P40.5 billion, was larger than public external debt payments at P28.7 billion. During the same year, the executive

branch, through the inter-agency Development Budget Coordinating Committee (DBCC), adjusted the budget by almost P18 billion without legislative approval. The legal prop used to justify this move was again PD 1177. In his testimony before the Senate finance committee, Budget Undersecretary Benjamin Diokno said the budgetary adjustment was accounted for by the increased appropriation for public debt service, from P61.4 billion (the approved amount) to P80.4 billion due to the rise in interest rates and currency revaluation.

It was the same story for the subsequent years. While several bills were proposed in both chambers of Congress, PD 1177 remains unrepealed to this day.

Early this year, President Aquino approved a P308.4 billion budget for 1992. Debt service allocations (for local and foreign public obligations) in the 1992 budget amounted to P110.03 billion or 36.65% of the total budget. Of this amount, P43.75 billion was for foreign debt service payments while payment for local public obligations totalled P69.28 billion.

Interest payments alone accounted for an annual 35% average of total government revenues. Average annual government revenues amounted to P125.70 billion during the 1986-1990 period. On the other hand, interest payments averaged P46.04 billion. From 1987 onwards, interest payments accounted for more than twice the size of the budget deficit. Without these interest payments, revenues would have exceeded expenditures for budget surpluses. Even if interest payments were reduced to only half, a balanced budget would result.

The larger budget allocations for local public debt service payments (compared to allocations for foreign debt service payments) have been pointed out by Aquino economic managers to argue that the government's foreign debt is less a problem than its local obligations. The government's domestic debts expanded from P88.4 billion in 1986 to P291.3 billion in December 1990 for a massive P202.9 increase over a four-year period. Then Budget Undersecretary Benjamin Diokno however established the direct linkage between the government's local and foreign debts. Diokno claimed that budgetary deficits only accounted for P67 billion, or 33.5 percent of the domestic debt expansion during the same four-year period. According to him, more than half (58%) of the growth in public local liabilities was due to the following foreign debt operations: 30% for interest payments of foreign loans assumed by the national government such as the loans incurred by the Philippine National Bank (PNB), Development Bank of the Philippines (DBP), Philippine Export and Foreign Loan Guarantee Corporation (or Philguarantee), and the Bataan Nuclear Power Plant; and 28% for the Central Bank's debt-to-equity conversions and other open market operations.

THE EVOLUTION OF THE AQUINO GOVERNMENT'S DEBT POLICY

Beyond the numbers, the evolution of the Aquino government's debt policy is a more instructive story. While candidate Aquino solemnly promised to be the dictator's exact opposite, she ended up continuing Marcos' economic and debt management program.

In the glory days after February 1986, one of candidate Aquino's campaign promises was honored. On April 30, Aquino and her cabinet unanimously decided not to operate the Bataan Nuclear Power Plant. That decision could have been spurred by the April 26 explosion of the Chernobyl nuclear plant in the Soviet Union which killed and maimed hundreds and subjected large areas to nuclear radiation. The promise of a new approach to the debt was also spurred by statements made by Aquino's first economic planning minister, Solita Monsod, of the need to put priority on the country's internal growth requirements before external debt service and the selective repudiation of tainted loans.

But soon afterwards, the government's debt policy started to veer towards the Marcosian policy of according top priority to debt payment at the expense of the country's economic growth and development. The retention of Jose B. Fernandez, Jr. as Central Bank governor by Aquino was a mere hint of this future turn.

The shift was made public during her first state visit to the United States. Addressing a joint session of the US Congress in September 1986, President Aquino promised to pay every single cent of the huge foreign debt her government inherited from the dictatorship even as she acknowledged in the same breath that a substantial portion of the debt was tainted with fraud and corruption and did not benefit the Filipino people. She declared before her adulating audience that it was a matter of honor that these debts be paid.

With this speech, Aquino foreclosed on what most observers consider to have been the best opportunity to obtain the best terms with the country's foreign creditors. As a revolutionary government, it was entitled under international law to demand at the very least an accounting of the previous regime's obligations on account of a strong and widespread perception that many were tainted or fraudulent. Given the political capital generated by EDSA, the Aquino government was likewise in a position to ask for a condonation of at least some of its debts. Poland, with its restored democracy, would reap the political rewards of the EDSA process with a cancellation of half of its bilateral debts in April 1991.

But no, President Aquino promised to pay all of the debts and no foreign creditor is about to complain. Apparently, the non-confrontational approach was adopted in the belief that foreign lenders would be more accommodating to her new and democratic government.

The linchpin of this approach is a stage-by-stage negotiating cycle with the country's creditors. It usually starts with an agreement with the top-cop creditor, the International Monetary Fund (IMF), which provides that the country adopt the obligatory "cut-the-excess-fat" austerity program designed to liberate domestic resources and allocate them liberally to service external obligations. An agreement with the IMF is considered a "seal of good housekeeping" and allows a debtor state to negotiate with its other creditors.

The next phase involves talks with creditor governments or bilaterals represented in the so-called Paris Club. Talks with commercial creditors usually come last and complete the negotiating cycle. The negotiations with the commercial banks are a two-stage affair. Philippine government negotiators deal with a 12-man Bank Advisory Committee (BAC), composed of representatives of the 12 commercial banks which had the most substantial loan

exposure in the country. The BAC represents the hundreds of commercial bank creditors to the country. After an agreement is forged with the BAC, it must be ratified by all the other banks before it takes effect.

Given the reluctance of private banks to extend credits to Third World debtors (a rational response of profit maximizers and risk minimizers during the debt crisis), it is to the commercial banks' interest to negotiate last with a debtor state. In so doing, they are able to determine what foreign governments and multilateral financial institutions are willing to provide the country. This knowledge enables them to limit to the possible minimum credits they would extend and therefore avoid over-financing the country.

The Aquino government went through the grind several times. Upon assumption to office, it requested the cancellation of an unfinished agreement between the deposed regime and the IMF. A new agreement with the IMF was reached in October 1986 which involved a standby arrangement of 198 million Special Drawing Rights (SDRs) and an SDR 224 million compensatory facility. In turn, the Aquino government promised to adopt an economic reform program which featured, among others, privatization, import liberalization, reduction of public deficits.

In January 1987, some \$832 million in debt was rescheduled with the Paris Club covering bilateral loans falling due in 1987 up to the first half of 1988. The rescheduled debt involved \$612 million in principal and \$220 million in interest.

A commercial loan restructuring/rescheduling agreement was reached with the Bank Advisory Committee on 27 March 1987. It was signed by the Philippine negotiators on 17 July 1987, ten days before the opening of the first session of the restored legislature—the Philippine Congress. It was finally ratified by all 483 creditor banks in December 1987. The agreement involved some \$13.2 billion in commercial debt inclusive of debts previously restructured by the Marcos government in 1984, obligations due within the 1987-1992 period, a \$3.0 billion short-run trade facility, and the \$925 million new money facility obtained during the last year of the Marcos administration, under the following terms and conditions:

(1) Previously rescheduled debt plus those due in 1987-1992 involving a total of \$9.32 billion were to be paid over a 17-year period (with 7 1/2 years grace period) at 7/8% over LIBOR from the previous 1-and-5/8% premium charged the Marcos government.

(2) The short trade facility was extended from end-1986 to June 1991. A margin of 3/4% over LIBOR was to be paid on the trade credits.

(3) Repayment of the \$925 million new money obtained by the Marcos regime in 1985 was not stretched out. However, the spread on the facility was lowered from a previous 1-and-6/8% to 7/8% over LIBOR.

(4) For each of the years during the 1987-1989 span, the Philippine government must prepay at least 4% (or \$37 million) of the \$925 million new money facility. Failure to

do so obliges the Philippines to pay a higher premium of 1 % over LIBOR. From 1990 onwards, the country must pay on time or pay a 1% margin over LIBOR.

(4) The commercial banks may opt to collect interest due them in the form of Philippine Investment Notes (PINs), dollar notes convertible into Philippine pesos worth 100% of their face value which investors could use to purchase equities of selected Philippine corporations.

The 1987 commercial bank package was better than the agreement forged by the Marcos government with the commercial banks in 1985 in terms of longer repayment periods and lower interest margins. The agreement, however, fell short of the government's own expectations since no new money facility was extended. While the Marcos dictatorship in its last year was granted new money worth \$925 million at a time when the Philippine economy was in its worse shape, the restored democracy of President Aquino did not get any. It should have been seen as a better indication of commercial bank attitudes towards the country.

The concessional drop in interest margins do not also compare favorably with terms granted to other Third World debtors. During the first stage of negotiations with the banks, the Philippine negotiating panel headed by then Finance Secretary Jaime Ongpin and then Central Bank Governor Jose B. Fernandez, Jr. broke off from the talks on the matter of interest charges. The bank advisory committee was reportedly unwilling to lower interest charges below 1-and-7/8% over LIBOR. In a hearing before the Philippine Senate, Fernandez revealed that the Philippine negotiators told their counterparts that "we did not believe that they were offering the Philippines a fair deal." Negotiations were resumed only after the January 1987 Paris Club talks were concluded. In the interim, Mexico was able to obtain a commercial bank package which included \$6.0 billion in new money and the reduction of interest margins to 13/16% over LIBOR.

With the resumption of the negotiations, the commercial banks told the Philippine panel that the concessional interest charges granted to Mexico would not be repeated. In exchange for longer repayment and grace periods, the Philippine side agreed to a higher 7/8% margin over LIBOR. However, after the conclusion of the Philippine package, the same banks which virtually composed the bank advisory committee for the Philippines and which had earlier insisted that the Mexican deal would never be duplicated, granted Argentina the same rate as Mexico.

However, it was commercial bank pressure on another front which immediately precipitated the famed presidential outburst in the inaugural session of the Philippine legislature. Aquino complained:

Let me put it bluntly... The saga of democracy had made great television, but no appreciable change on their (creditors) business priorities. We were treated not much better than other debtors, even those that had rejected the austere discipline mandated by restructuring. A discipline we had readily accepted. Incredibly, despite significant reduction in country risk affected by the democratic restoration, we were not accorded the terms given other

countries, which got longer periods, better rates and greater latitude for growth.

Under the continuing threat of a cutoff in trade credits, which would have given new vigor and a signal to seize the moment to the enemies of democracy, we had to relent and sign the accord.

Nothing is more revealing of the tenor of the negotiations than the insistence that our government assume the responsibility of Planters Products to a consortium of banks. The private risks would have to become our public liability. Nonetheless, the demand stood and provided the none too subtle coercion — sign or face the prospect of a protracted delay in the finalization of the debt restructuring program agreed to in March 1987.

We do not bow our heads in shame for the shame is not ours. Yet even as necessity has forced our hand to agreement, we vow never again to let the patrimony of this nation lie at the feet of these noble houses that have finally shown the true face of foreign finance.

A member of the bank advisory committee, Barclays of Great Britain, pressured the Philippine government to unequivocally assume the obligations of the floundering Planters Products, Inc. (PPI) at the risk of non-ratification of the agreement with all 483 of the country's commercial bank creditors by mid-July 1987. Barclays headed a syndicate which had lent PPI a total of \$56.5 million. This was not the first time that PPI's creditors tried to get things in their favor. They tried first with the Marcos government when the latter was also negotiating for additional credits and a new repayment program in 1985. At the time, the commercial banks had to be content with a "Letter of Undertaking," a promise of the Philippine government to fully support the "successful rehabilitation and continuing viability" of the failing company.

The ownership of PPI was at the heart of the controversy between two Philippine governments and PPI's creditors. The dividing line between private and public entities during the Marcos regime was significantly thinned by the establishment of quasi-public corporations and the granting of so-called "behest loans". PPI was a large farm-products company which enjoyed a near-monopoly market position during the martial law period. It was legally and essentially a private firm but enjoyed substantial government financial support because of its strategic role in the Marcos government's rice self-sufficiency program. The picture was further complicated by the Marcosian trick of camouflaging his control or takeover (through trusted aides or cronies) of a strategic company or industry. PPI was supposed to be owned eventually by all the country's farmers; in the meantime, Marcos appointees acted as trustees for them.

It must be noted that Aquino complained of bank pressure but still agreed to assume the PPI obligations through Executive Order 219 which appropriated P620 million for the purpose. In the uproar following the presidential speech, the Senate voted to repeal E.O. 219 affirming the unconstitutionality of government assumption of private liabilities. A compro-

mise formula, however, still involved payment by government of P397 million, a smaller but still substantial amount.

The presidential speech would be Aquino's first and last tirade against the country's creditors. In fact, it was an aberration. Her promise not to compromise the national patrimony with the "noble houses of foreign finance" would be conveniently forgotten. The earlier promise before the US Congress was a more faithful indication of her government's debt policy.

PROTAGONISTS IN THE DEBT DEBATE

A critical review of the early years of the Aquino government's debt management program reveals that it was an all-executive branch affair. The debt negotiators were members of the Cabinet. The IMF standby agreement reached last October 1986 was an executive agreement. This may be understandable since there was no standing legislature at the time. The debt restructuring agreement with the commercial banks was signed by Ongpin and Fernandez on behalf of the Philippine government ten days before Congress convened, raising justified suspicion that preemption of Congressional action was desired. When asked whether Congress could review the July 17 agreement with the banks, Ongpin opined that there was no need to do so since no new money was involved, and that it was not a treaty that had to be ratified by the Senate.

To be more accurate, it must be pointed out that debt policy making became the monopoly of a small coterie within the executive branch headed by the finance secretary and the Central Bank governor. While economic matters were the subject of the authority of the Cluster E within the Cabinet, then Economic Planning Secretary Monsod had increasingly marginal participation in debt negotiations and was eventually eased out of the picture.

The 1987 Constitution, among others, restored a tripartite and co-equal check-and-balance government composed of the executive, legislative and judicial branches and upheld Congress' control over the disposition of public funds. Armed with these basic provisions, the legislators reacted immediately to Aquino's first State of the Nation address. Both houses initiated investigations of the PPI deal and called the debt negotiators to committee hearings. In addition, several bills and resolutions on the debt issue were filed in both legislative chambers.

Inspired by the framework of recognizing "the primary need to service economic growth," these included proposals to limit annual debt service payments to 10-15% of annual export earnings; the repeal of PD 1177 which provided for the automatic budgetary appropriation for public debt service payments; selective disengagement whereby odious and tainted debts were to be identified and thereafter resolved through negotiations, arbitration and litigation; a moratorium on debt payments (from three to six years); the formation of a Joint Executive-Legislative Debt Commission which would formulate a comprehensive national debt policy; and the formation of a new debt negotiating panel to be headed by a senior diplomat "to infuse a political outlook" to the debt talks. All of these moves should

be interpreted as the legislative's refusal to accept the executive branch's monopoly of debt policy and management.

These legislative initiatives merely amplified earlier demands raised by the broad anti-dictatorship movement since the Aquino assassination. After the fall of Marcos, the alternative debt movement got consolidated with the establishment in March 1988 of the Freedom from Debt Coalition (FDC) which included several center-left political federations, civic organizations, academics and research institutions, among its membership. Without parallel elsewhere in the debt-ridden Third World, FDC will emerge as the acknowledged extra-parliamentary nemesis of the Aquino government on the debt front.

In response, Aquino's finance managers opposed these alternative debt proposals with the familiar refrain: let us not antagonize our creditors because they would then not lend or give aid to us. However, the key role played by Cory's allies in Congress, particularly the leadership of the House of Representatives helped prevent their passage into law. These allies practically owed their electoral victories to the President and some others were Aquino's relatives.

In the instances where legislative initiatives were passed into law, the resulting legislation would invariably be a watered-down version reflecting the real balance of power between Cory and Congress. This was the case with the bill proposing the creation of a legislature-dominated Joint Legislative-Executive Foreign Debt Commission (JLEFDC) charged with the formulation of policy on domestic and foreign debt and the appointment of debt negotiators.

Aquino vetoed the JLEFDC bill in February 1989 and asserted the executive's primary role in debt policy making. The Senate managed to nullify the presidential veto but the House failed to match this deed.

However, Aquino had to court congressional support for a new three-year agreement with the IMF in March 1989. Then Finance Secretary Vicente Jayme and CB Governor Jose B. Fernandez were again summoned to legislative hearings to explain the government's proposed economic program. A significant number of legislators associated with the JLEFDC bill had expressed opposition to the harsh terms of the new IMF program. In addition, a broad citizens movement against the same agreement was formed in April 1989. Called CALOI (or Coalition against the Letter of Intent), it was spearheaded by the Freedom from Debt Coalition (FDC).

In the end, the legislators agreed to the LOI on the promise that a review of the economy be made after six months and that necessary revisions could be made on its terms. To further appease the legislators, Aquino agreed to create a joint legislative-executive debt body. But she insisted on her previous policy prerogatives. The resulting agency, the Joint Executive-Legislative Foreign Debt Council (JELFDC), had its leadership and membership tilted in favor of presidential appointees. It could only recommend rather than appoint the country's debt negotiators. But more substantially, the body could only recommend rather than formulate and execute debt policy. In the final analysis, the body affords a token role for the legislative in debt policy making.

THE PAP BROUHAHA AND THE TAMING OF MONSOD

After some self-imposed silence during the late 1986-1987 period, Secretary Monsod reiterated publicly her economic-growth-before-debt payment opinions. She proceeded to clash with the Finance-CB tandem on the austere conditionalities of the proposed three-year (1989-1991) agreement with the IMF, particularly the dangers posed to the modest growth targets set by the Aquino government and enshrined in the 1987-1992 Medium-Term Philippine Development Plan (MTPDP). Secretary Vicente Jayme and CB Governor Fernandez got President Aquino to exclude NEDA chief Monsod from the negotiating panel, especially in talks with commercial banks. Monsod also had marginal participation in preparing the draft LOI.

The sharpest cut in Monsod's powers involved the transfer over the disposition of official development assistance (ODA) from the NEDA to a newly created Coordinating Council for the Philippine Assistance Plan (CCPAP). The PAP, also known as the Multilateral Aid Initiative (MAI), was initially touted as a mini-Marshall plan for the Philippines involving international aid worth \$2.0 billion (\$1.0 billion initially) annually for a five-year period (with the first outlay to start in 1988); the encouragement of foreign investments in the country; and improved terms in trade between the Philippines and the major industrialized countries.

The denial of NEDA's function to manage ODA funds introduced serious questions as the presidential action transpired an important function away from a constitutional body to an entirely new one created only by presidential administrative order. It also triggered the resignation of Monsod as NEDA head by mid-1989. In an effort to head off a possible constitutional debate, President Aquino issued Administrative Order No. 128 dated 23 June 1989 which created the Committee on Official Development Assistance (CODA) of the NEDA. CODA was authorized by this order to "undertake the various aspects of the official development assistance (ODA) including programming, coordination of program and project development and of negotiation for foreign assistance and monitoring of and where necessary, supervision of the project implementation." The membership of CODA was almost exactly the same as that of the CCPAP except for the legislative and private sector representatives. The CCPAP chairman Roberto Villanueva was named by the order as CODA chair. In addition, President Aquino named Villanueva and CB Governor Fernandez to the NEDA Board.

At this point, the linking of several ongoing negotiations was used by Aquino's financial managers to get their way. One of the reasons they asked for speedy congressional approval of the LOI submitted to the IMF was to facilitate the PAP program, the latter to start with a Tokyo donor pledging session in July 1989. The agreement with the IMF was also a prerequisite to obtaining a new agreement with the commercial banks.

Using a hard-sell approach, the financial managers made it appear that the PAP represented new development funds from international donors for the country. Their critics, including Monsod and FDC, argued that the PAP was just a repackaging of ODA funds

already committed or in the pipeline from various sources lumped together in a high-profile package to suggest largeness.

The Tokyo pledging session was held with \$3.5 billion in loans and grants obtained for 1989. The top pledgees, as reported in the press, were: Japan, \$1.602 billion; the World Bank, \$750 billion; the Asian Development Bank, \$505 million; Italy, \$270 million; US, \$200 million (although \$281 million representing the non-military component of the military bases aid package was included in the \$3.5 billion total); Spain, \$65 million; the Federal Republic of Germany, \$57.4 million; France, \$57 million; and the EEC, \$20 million.

Of the total amount pledged, NEDA officials asserted that some \$2.7 billion had already been committed to the Philippines under regular ODA programs. This means that the PAP has only raised new money totalling \$800 million, a far cry from the promised \$2 billion new inflows annually. It was likewise clear that these were just pledges which had to be confirmed by the appropriate political processes in their respective countries. For instance, the US House of Representatives voted to grant only \$160 million, \$40 million short of the commitment made by U.S. State Secretary James Baker in Tokyo. A key opponent of the PAP in the US House of Representatives was Rep. David Obey (Democrat-Wisconsin), chairman of the House subcommittee on foreign operations and export financing, who noted that the Philippines had a poor record of ODA absorption and utilization.

Despite the promise to consult with Congress, outgoing CB Governor Fernandez and outgoing Finance Secretary Jayme committed the country to an even more draconian economic program through a Supplemental Memorandum submitted to the IMF on the first day of the December 1989 coup. All of these moves were made secretly betraying the negotiators' low opinion of the value of legislative counsel. Their moves would have remained secret following the confusion and anxieties spawned by the coup, were it not for a journalist who informed the public. The legislators expectedly criticized the secrecy and the onerous terms of the new program. But the new negotiators, Economic Planning Secretary Jesus Estanislao and CB Governor Jose L. Cuisia, Jr., insisted on the need for secrecy in negotiations.

THE BRADY PLAN AND THE 1989-1990 COMMERCIAL BANK PACKAGE

US government response to the Third World debt crisis, following its armtwisting of banks for the resolution of the Mexican debt crisis of 1982, took shape with the so-called Baker initiative enunciated by Reagan's treasury secretary James Baker. The essence of this initiative was to call on commercial banks to reschedule existing debts and voluntarily provide more new credits to enable Third World debtor states to grow out of their debts. For their part, debtor states had to implement "economic reform" programs which invariably featured austerity, import liberalization, export promotions and privatization measures.

The Baker plan failed to induce the flow of new commercial debt into the Third World. Commercial banks responded by simple rescheduling and providing reserves against doubtful accounts, but shied away from providing new loans. In the process, their loan

portfolio became more secure, their dangerous exposure to TW debtors was limited, and their income statements reflected increased earnings through higher interest charges (from re-scheduling and restructuring).

The plan's severe limitations were underscored by the IMF riots in Venezuela and Jordan (where hundreds were killed as mass protests escalated against IMF-inspired austerity programs) and the plunging value of Third World debt paper in the secondary markets. The latter development was a pessimistic appraisal of the possibility that TW debtors could outgrow their enormous debts.

US President George Bush directed Treasury Secretary Nicolas Brady to announce a new initiative that eventually bore the latter's name. The general idea of Brady's plan was that debtors who agreed to strict IMF programs would qualify for limited debt relief. Qualified debtors could then set aside some of their multilateral loans to buy back their commercial debts at a discount. Or, alternatively, the countries could use some of this money to guarantee future interest rates to banks that would offer some debt relief on their own. This was supposed to offer incentives to banks to voluntarily write-off some debts.

Venezuela, Mexico and the Philippines were later identified as initial beneficiaries. The agreement forged between the Philippine government and the commercial banks in early 1990 hewed to the parameters of the Brady initiative.

The new Philippine financial package consists of two major features: a direct buy back of debt owed to commercial banks worth \$1.337 billion at a 50% discount using funds borrowed from the International Monetary Fund (IMF), World Bank, Japanese Export-Import Bank, and the Overseas Economic Cooperation Fund (OECF) of Japan, and advanced by the US government; and the provision of fresh loans through the flotation of uncollateralized Philippine bonds at the Luxemburg stock exchange. While initial expectations fanned by our negotiators involved raising \$1 billion, 84 creditor-banks agreed to provide \$714.75 million only.

A third but secondary feature of the agreement with the commercial banks involves the restructuring of a \$925 million loan obtained by the Marcos government in 1985. Payment of this loan was rescheduled over another 15 years, with an eight-year grace period at an interest of 13/16% over LIBOR, down from a previous 14/16% premium. This means a yearly interest reduction of \$0.58 million (equivalent to 1/16% of \$925 million) on the 1985 loans.

All told, the new financial package will mean an annual interest reduction of \$86.58 million for the Philippines, fresh commercial bank loans totalling \$714.75 million, and a net reduction of \$48.85 million in the country's foreign debt stock. The figure for net debt reduction is computed by subtracting the \$573.4 million borrowed from multilateral financial institutions to finance the buy-back and the \$714.75 million in new commercial credits from the \$1.337 billion worth of commercial debt purchased under the buy-back arrangement. More accurately, the entire package means a reduction in the country's debt to commercial banks by \$622.25 million (\$1.337 billion debt retired minus \$714.75 million new money) and an additional \$573.4 million in debt due to the IMF and other public

multilateral agencies.

Mrs. Monsod would criticize the commercial bank package on two counts: the new money would not be enough to fill a \$1.3 billion financing gap for the 1989-1990 period, with new money inflows coming in late; and that it was inferior to the package obtained by Mexico in July 1989.

The Mexican accord featured a three-option menu for the country's commercial bank creditors:

A 35% (not 30% as Mr. Cuisia alleges) reduction on \$54 billion medium and long-term loans through a debt-for-bond swap;

A reduction of interest to a fixed 6.25% on outstanding obligations; or

Granting of fresh loans equivalent to 25% of total commercial debt outstanding.

The 7 August 1989 issue of Time magazine calculated that the deal could provide Mexico with about \$4 billion in loan reductions, \$6 billion in interest rate reductions, and \$2.5 billion in new credits, for a grand total of \$12.5 billion over a four-year period. This calculation was an estimate of how the 1,000-plus bank creditors of Mexico would respond to the package. Some analysts have opined that the operative discount on outstanding commercial debt was actually only 20%, not 35%, if the provision which allows creditor banks to share in the windfall gains that Mexico may earn after eight years should oil prices improve over price levels currently assumed is taken into account.

Monsod noted that the proceeds from the bond float will not come in when they are needed. The indicative term sheet of the agreement with the Philippines provided that banks had up to June 1991 to purchase the bonds. As discussions in the Foreign Debt Council indicate, the financing gap was unevenly spread, with \$1.0 billion needed in 1989 while only \$300 million was needed the following year. There were reports that the earliest date that part of the bond float proceeds worth only \$600 million could be made available was late January 1990 with two \$200 million tranches expected by June and December of the same. This arrangement was arrived at to assure commercial bank creditors that none of the fresh money they provided would be used for the direct debt buy-back, which was expected to be implemented in early January 1990.

As a result of the deal, some \$1.3 billion in commercial debts was retired through the buy-back arrangement. There was, however, no full report on new money availment; instead, there were indications that the Philippines had not been entirely successful on this account.

CALAMITIES, NATURAL AND MAN-MADE, AND DEBT

In July 1990, Luzon was struck by a killer earthquake which registered 7.7 on the Richter scale and caused deaths and massive destruction of crops, property and public

infrastructure. As if equally distributing the damage, the south was battered by typhoon "Ruping" in November destroying assets worth billions of pesos. The Gulf crisis spawned by the Iraqi occupation of Kuwait in August 1990 dislocated some 63,000 Filipino workers and affected dollar inflows.

Then, in June 1991, Mt. Pinatubo exploded after lying dormant for six centuries, causing even greater damage and dislocation of entire communities in several Central Luzon provinces expelling the Americans from Clark Air Force Base in the process.

These calamities have renewed the clamor for a more accomodating debt management policy. In the aftermath of the 1990 quake, Congress decided to ask for a suspension in debt service payments, while the influential Catholic Bishops Conference of the Philippines (CBCP) questioned the morality of continued debt service in the midst of suffering and economic difficulties.

Aquino and her financial technocrats continued to defend their debt policies and warned that the international community would be tightfisted with relief and reconstruction assistance if the country became "confrontational." Estanislao and Cuisia promised to work for the immediate holding of the second PAP pledging session so that relief funds could be raised. They were able to obtain \$500 million in earthquake relief but largely in loans rather than in outright grants causing critics to complain that they only added to the country's already heavy debt burden and to express disgust that emergency aid was extended under standard arrangements.

Before the year was over, it was clear that the economy was slipping and the targets on budget deficits promised the IMF could not be met. Around this same time, Monsod started airing her proposal for the country to go into temporary arrears on its commercial debts to reduce government expenditures, relieving pressure on government finances without sacrificing other vital public expenses on social and economic services and infrastructure and imposing the counterproductive 9 percent levy on imports. She also argued that going into temporary arrears would improve our negotiating leverage without putting us in default.

Aquino's managers opted instead to impose the import levy, increase domestic oil prices, reduce vital government expenditures, and pursue restrictive money policies (which raised interest rates) instead of tampering with the sacrosanct debt service. President Aquino predictably vetoed the debt-ceiling proviso of the 1991 budget law and resisted new proposals for a payments moratorium in the wake of the Pinatubo disaster. These policy measures can better explain the current recession than the natural calamities and international developments.

Her financial managers also tried hard to drum up support for a new bases treaty by joining the shrill chorus of warnings over the potential loss of foreign exchange, jobs, official aid, and trade credits with the bases withdrawal. Estanislao and Cuisia also pointed to the prospect of debt relief from the US (contained in the much-publicized but ambiguous letter of Bush to Aquino) as further inducement for the treaty. Cuisia also asserted that commercial bank approval of a new loan package would depend upon the Senate vote on the bases treaty and the inclusion of Bataan nuclear plant debts in buy-back arrangements.

This was not the first time that a disadvantageous link between the foreign debt and the US military bases in the country was sought. In 1987, prominent business leaders such as Enrique Zobel and the late David Sycip proposed a "debt-for-bases" swap. Under the arrangement, the US would contribute money that could be used to retire Philippine debt through buy-back operations in exchange for the continued stay of the US bases in the country. A variant recognized the fiscal difficulties of the US government and proposed that the Japanese government, also a beneficiary of the US military presence in Asia, foot the bill. The 1988 Manglapus-Schultz agreement on the bases in fact contained a provision enabling the Philippine government to use part of the "rental" payments for debt reduction. Drumbeaters also tried to inflate PAP fund inflows by including the bases "rentals" for 1990-1991.

A basic objection, based on the notion that the debt and the bases are distinct issues which both deal with crucial issues of national sovereignty and could not be "swapped," carried the day. The new bases treaty was rejected by the Senate in September 1991.

THE NUCLEAR PLANT SAGA

The single most important illustration of Aquino's debt management program is the story of the Bataan nuclear plant. It will be recalled that among the very first and much applauded decisions of the government was the plant's mothballing. Then it created the Presidential Committee on the Philippine Nuclear Power Plant (PCPNPP) to study legal options available to government. The Senate organized its own counterpart committee headed by Senator Renato Saguisag; the House did not follow suit. It took the presidential committee more than two years to prepare a case of fraud against the plant's supplier and builder, Westinghouse and Burns & Roe, respectively.

The key elements of the case include the following:

(1) Westinghouse apparently paid substantial bribes to President Marcos, through Herminio Disini, to win the supplier's contract over General Electric. The decision to award the contract to Westinghouse was Marcos' own, overruling the objections of many of his own officials and subordinates.

(2) After winning the contract, Westinghouse overpriced the plant to the point of becoming the most expensive plant of its kind in the world.

(3) The nuclear plant supplied and built in Morong, Bataan was saddled with innumerable defects and was basically unsafe to operate. It was, in American sales lingo, a billion-dollar "lemon."

The period spent by the PCPNPP to prepare its case was also an opportunity to strike an out-of-court settlement with Westinghouse and Burns & Roe. When no deal was reached, the Philippines filed suit against the American firms before the US federal court of New Jersey, the state where both respondent firms had offices, on 1 December 1988.

In April 1989, Federal Judge Dickinson R. Debevoise ruled to split the Philippine government suit into two: litigation with his court and arbitration with the Geneva-based International Chamber of Commerce (ICC). Debevoise ruled to retain jurisdiction over the lawsuit's charges concerning bribery, corruption and other misdeeds not connected with the supplier-builder contract. The other thirteen counts in the suit involving claims of fraudulent, illegal and improper conduct in the procurement of the PNPP contract were passed to the ICC.

At home, however, the executive branch continued moves which tended to weaken the Philippine suit against Westinghouse. First, President Aquino vetoed a provision in the 1990 budget law discontinuing payments on the nuclear plant loans. Then, debt negotiators tried to include BNPP debts in the buy-back program of the 1989-1990 commercial bank package. If these debts were retired through the buy-back arrangement, it would, in the opinion of critics such as Senator Saguisag, weaken the Philippine suit against Westinghouse. In addition, inclusion of BNPP paper in the 50% buy-back arrangement (where one pays 50% of the face value of the loan to be retired) does not make sense because such debts were selling at 10-15% of face value in the secondary markets. It may make sense to entities who bought them earlier at those rates because they could realize 35-40 cents earnings on every dollar of BNPP debts sold. These raised speculations that certain individuals and institutions would make a killing based on "advanced insider information."

In crucial meetings of the JELFDC held late in 1989, the non-inclusion of BNPP debts in the buy-back was upheld by a close vote. The oppositors asked Fernandez to furnish the council with a list of papers bought back to ensure BNPP non-inclusion. Fernandez promised to do so after the fact; this promise was not honored.

In July 1990, the debt council, however, voted in favor of including BNPP paper in future buy-back arrangements. The vote was reportedly reached without a quorum. Estanislao and Cuisia pushed for a categorical decision on the matter when most of the oppositors were absent.

In 1991, both made explicit recommendations that BNPP paper be included in the commercial bank agreement being negotiated. The Senate responded by passing on 7 August 1991 a unanimous resolution rejecting the inclusion of nuclear plant loans. Again, insinuations about windfall profits were raised as the secondary market price of BNPP paper rose every time the country's financial managers proposed their inclusion in buy-back schemes. Estanislao, Cuisia and their allies backtracked so that the JELFDC voted the next day to defer a decision on the matter pending investigation of alleged "insider profiteering."

Cuisia returned from New York early September with a new package forged with the commercial Bank Advisory Committee. He said, however, that final approval of the agreement would depend on the Senate vote on the new bases treaty with the US and the inclusion of BNPP loans in the package.

Securitization of dirty loans was the preferred arrangement. This involved the transformation of BNPP debts into new debt instruments, a transaction which would

remove all of the infirmities of a tainted obligation. In various public hearings conducted by the JELFDC around the country, the overwhelming sentiment was for the suspension of Bataan debt payments. In the end, President Aquino again vetoed a provision to that effect in the 1992 budget law. In another subterfuge, a reduced JELFDC quorum (excluding the oppositors) voted on 15 January 1992 to go ahead with the securitization of Bataan debts.

In the US, Judge Debevoise earlier ruled on 20 September 1991 that there was ample evidence that defendants Westinghouse and Burns & Roe bribed Marcos to corner the nuclear plant contract. The ruling allowed the three-year suit to proceed to trial by February 1992. The Debevoise ruling prompted Senator Guingona to ask anew for the suspension of Bataan debt payments, which was dutifully rejected again by Aquino. Before the year ended, allegations about improper conduct of key bank financiers of the nuclear plant hit the headlines.

Senators Guingona and Saguisag accused members of the Cabinet of suppressing the December 1988 recommendations of American counsel retained by the Philippine government to investigate Citibank and the Asia Pacific Capital Corporation (APCO), an affiliated institution based in Hong Kong for possible improprieties in obtaining the lead manager's role for the private financing of the nuclear project. The Citibank-APCO tandem reportedly managed to wrest from American Express and Manufacturer's Hanover Trust the role of lead manager of a \$256.6 million commercial package for the plant through Disini's intercession with Marcos and in close coordination with Westinghouse, a parallel of Westinghouse's coup over General Electric and Burns & Roe's over EBASCO.

Allegations of bank fraud in the Bataan deal initiated investigations on two fronts—the Senate Blue Ribbon Committee and a special three-man committee created by Aquino and headed by then Justice Undersecretary Eduardo Montenegro—as well as forced the inclusion of the so-called “no-waiver clause” in the proposed commercial bank agreement. The no-waiver clause was claimed by Estanislao and Cuisia to provide ample protection of Philippine interests because it offers the opportunity to file suits against erring banks should adequate evidence surface in the future.

The special committee apparently finished its work ahead of its Senate counterpart, but its findings were kept confidential. Informed sources disclosed that the committee voted to recommend the exclusion of the entire \$256.6 million syndicated loan in the commercial bank package. But on 17 February 1992, just as talks with the banks opened anew in New York, Montenegro (now justice secretary vice Franklin Drilon who became executive secretary) changed his mind and recommended instead the non-inclusion of only Citicorp's \$19.3 million participation in the syndicated loan. Cuisia then claimed that Citicorp “voluntarily” agreed to exclude its contribution during the New York talks.

Before the Senate committee could release its findings, Manila was again rocked by news that an out-of-court settlement had been reached to Westinghouse suspending jury trial in New Jersey. Announced by Saguisag, the settlement provided that the Philippine government receive \$10 million in cash and \$90 million in credits and discounts from Westinghouse. In turn, the Philippines will allow the plant to be repaired by Westinghouse through a \$400 million loan extended by the US Export-Import Bank (the plant's original

single largest financier) and will pay the same firm \$1.2 billion over a 30-year period.

The settlement was predictably slammed by almost all quarters and much of the ire was directed toward Saguisag, an erstwhile oppositor to the power plant. Saguisag tried to defend himself by claiming that the settlement must still be approved by Congress, a defense weakened by a categorical statement by Westinghouse that that was not the case. In addition, the question of nuclear waste disposal was also excluded from the said settlement.

The bitterness was fanned further by renewed insinuations of insider profiteering, disclosure of a hitherto confidential report regarding non-consideration of dangers posed by nearby fault lines and volcanoes, the release of the Senate Blue Ribbon Committee report claiming adequate evidence of Citibank's fraudulent activities in relation to the nuclear plant's financing, and the premature clearing of the bank by Cuisia.

A parallel and related debate focused on the 1991-1992 commercial bank package. This agreement, to be finalized on April 14, includes these options for the banks: lend \$100 million in new money or exchange existing obligations with either an interest reduction (IR) bond or a principal collateralized interest reduction (PCIR) bond. Cuisia calculated that the package will provide cashflow relief of \$2.3 billion over the next six years.

In addition, debts could be bought back at a 48% discount (meaning 52 cents for every dollar debt), using funds that the Philippines could raise from official lenders and its own foreign exchange reserves. The government intends to use \$500 million of its own reserves initially while awaiting loan releases from the IMF, the World Bank, and the Japan Export-Import Bank, the same institutions which provided financing for the 1990 buy-back deal. Cuisia added that the advances made "may or may not be reimbursed" by the said institutions. The IMF is expected to contribute \$200 million while Japan Eximbank will pitch in a lower figure. The World Bank contribution was estimated at \$70-100 million, part of a new \$300 million "economic integration loan" being sought by the Philippines.

Opposition to the package focused on two issues: the inclusion of BNPP paper and the amount of relief afforded by the package. Citizens groups like the Freedom from Debt Coalition (FDC) anchored much of their opposition on the Bataan deal. Academics from the UP School of the Economics deflated the claims for cashflow relief and noted that a simpler rescheduling may yield better terms for the country. Oppositors also questioned the wisdom of an agreement involving non-reschedulable/non-restructurable bonds struck during the dying months of an outgoing administration. It was a reprise of the previous debate over the 1990 package.

To drum up external support in the face of severe internal criticism, Estanislao and company undertook a whirlwind of activities during the first quarter. The country's 1992 "economic stabilization" program which again called for increased tax collection and reduced public spendings was approved early March by the IMF after several months of delay. The negotiators also managed to transform the March 12-13 consultation with Paris Club creditors into a PAP pledging session and raised a total of \$1.7 billion to finance, among others, rehabilitation of Pinatubo-damaged areas and several electrification projects. In

addition, creditor governments indicated willingness to cancel a portion of \$1.5 billion in maturing official obligations. France led the way with a \$4 million debt-for-development transaction. Needless to say, all of these financial accommodations are accompanied by the familiar "reform" conditionalities.

WE JUMPED HIGH, DIDN'T WE; BUT WHERE DID WE LAND?

The Aquino government started office with the objective of effecting a recovery for the Philippine economy from the debt-driven recession of 1984-1985. In concrete terms, this meant annual real GNP growth of 6.5% so that 1992 per capita income could return to 1981 levels. To achieve these targets, the medium-term economic plan had a growth-before-debt-service orientation, a basic policy thrust affirmed by several debt laws and resolutions passed by the restored legislature since 1987.

The basic growth targets were never met; debt service crowded out internal requirements. After an initial upswing, economic expansion started to decelerate since 1989 such that the Aquino government is similarly presiding over a recession while on its way out. For an import-and-foreign-exchange dependent economy, dollar starvation can only lead to economic slowdown.

Aside from the legacy of a recession, the Aquino government has transformed the country's public debt in many ways. It resorted to massive internal borrowing to finance economic growth (in the absence of net dollar inflows) and to help pay the external debt. Domestic borrowing raised domestic interest rates which in turn dampened investments and economic expansion. It even used part of the dollar loans it got to retire old debts instead of using it for internal purposes. In its never-ending quest of the IMF's blessings, it assumed many public obligations while attempting to keep public deficits to target levels. To do so, it crimped on vital public expenditures on education, health and infrastructure, compromising future basis for economic expansion and eroding lower-class incomes in the process.

A four-fold transformation of the debt problem has been effected.

First, the foreign debt, from being mainly commercial, is now principally owed to official creditors including foreign governments and multilateral institutions. While commercial bank conditionalities revolved principally around profit considerations, official creditor concerns take on larger dimensions including foreign policy and security matters and bitter economic reform medicine.

Second, foreign debt obligations are now largely in the hands of the national government, as it assumed many private debts and obligations of state financial institutions and corporations. This means that payments for these obligations became a heavier item in the national budget.

Third, the recourse to internal borrowing has spawned an unprecedented internal public debt problem that will occupy post-Aquino governments. Domestic debts rose from P125 billion in 1985 to about P400 billion by 1991-end. Most of these domestic debts are

high-yielding short-term government securities and will similarly eat up a significant amount of post-Aquino public funds. Pressure to maintain public deficit levels will force government to continue curtailing vital expenditures or imposing easily-collectible regressive taxes.

Lastly, a significant amount of commercial debt has been transformed since 1987 into less flexible non-restructurable bonds and the April 14 agreement, if it pushes through, will add to it. This has serious implications on the cash flow requirements of Philippine governments well into the 21st century. The April 14 agreement will also sanitize several tainted debts, including Bataan paper, and undermine possible future efforts at disengagement and litigation. In combination with the out-of-court settlement with Westinghouse, the wallop from this corner becomes deadlier.

There is another potential source of danger in the future: the 1991 Local Government Code affords local government units the authority to contract debts (foreign and domestic) on its own with only a modicum of central government supervision or control.

On the other hand, the continuing debt debate elevated an otherwise obscure specialist question high up in the nation's agenda. Public awareness was widespread and opposition to the government's debt policies was steadily manifested through opinion polls, pastoral letters, public hearings and the like.

WHAT SHOULD WE DO?

Different recommendations could be made for the remainder of the Aquino term and for the incoming administration.

In the interim, the strongest possible opposition to the out-of-court Westinghouse settlement and the Bataan debt paper securitization should be mounted. One way would be to ensure that these questions become significant electoral issues. Another is to work for the present Congress to decide on the Westinghouse settlement.

The prospects seem to be dim for any significant breakthrough in the next two months. This means that the contest to fashion a better public debt management program has to be fought with the next administration. An administration led by Mitra, Ramos or Cojuangco will most likely continue the basic contours of existing economic policy.

Nevertheless, the incoming administration will face the following constraints and possibilities. Whoever wins may want to ease the tremendous pressure on the public debt front.

Differential treatment of creditors should be a basic item on the new government's debt strategy.

First, there appears to be a greater readiness on the part of several governments, particularly European, to cancel official debt. A more vigorous diplomatic initiative should work on this possibility. The support of international bodies, such as ILO, UNICEF,

UNCTAD, and the churches for debt forgiveness should actively be solicited by Philippine diplomacy. In addition, a judicious mix of going-it-alone and concerted diplomatic moves with other debtor states should be studied and, if feasible, implemented. The opportunity is offered by the Manila Declaration (of the Conference of Restored Democracies); the diplomatic slogan to be adopted—"Give Democracy a Chance, Cancel Unpayable Debts!" Non-government diplomatic efforts should also be encouraged.

The further reduction of commercial debt exposure to the country both weakens the country's negotiating leverage with the banks and increases commercial banks' reluctance to lend new money. In a situation where the resource outflow is in favor of the creditor, the debtor has curiously greater powers to direct and control payments since net new loans are not forthcoming anyway. Insofar as the non-bond portion of the commercial debt is concerned, the country should work for reduced if not for zero net outflows. The tactic of going into temporary arrears on this portion of existing commercial debt should be studied to gain negotiating leverage.

Another source of negotiating leverage is the "conflict with municipal law" argument. PD 1177 should immediately be repealed so that a potential quidproquo arrangement could be secured with commercial creditors. The Supreme Court ruling upholding the constitutionality of the Marcos decrees should be challenged anew to open battle on another front.

It goes without saying that the present economic managers and debt negotiators be replaced. In addition to replacement, future negotiators should not have blanket plenipotentiary powers (or at least not to be perceived by the other side as having such powers) for more effective negotiating. There may be in certain instances need for immediate decisions *in situ*. But our negotiators should also have the flexibility to gain concessions from the other side by pointing to the need to please principals at home.

Vigorous investigation of tainted loans should also provide additional leverage. An independent multi-sectoral ad hoc commission could be organized for this purpose. If not, parallel studies conducted by public (such as the Commission on Audit) and private agencies could be undertaken for cross-checking and to avoid whitewashes. Appropriate legislative and political support should be given to these bodies. Attention should be directed to banker liability (including the US Export-Import Bank) in the Bataan nuclear plant deal. Fiduciary institutions in principle dislike bad publicity, and the more solid our cases are, the stronger the negative publicity will be.

While a stronger posture is recommended vis-a-vis commercial creditors, a spineless stance toward official and multilateral creditors should not be taken, either. The incoming administration will still have to deal with the IMF. However, it can put political pressure to bear on the IMF with respect to austerity measures by citing provisions in the IMF charter itself against the adoption of measures detrimental to the general economic health of countries. These diplomatic pressures could best be applied in concert with other debtor governments, to include the former Soviet bloc states.

At home, the domestic public debt problem has to be dealt with. The best way out is to stretch the maturities of present government securities outstanding to relieve cash outflows in the near future. The indiscriminate passing on to the national government of public sector obligations must be stopped. The efficacy of creating a separate government agency to absorb these liabilities should be studied.

As a matter of principle, the formulation of the country's debt policy should draw inputs from all sectors of society. The participation of extra-parliamentary people's organizations should be encouraged and solicited. The revamp of the current Joint Executive-Legislative Foreign Debt Council into a broader-based and more powerful Debt Commission is a necessary step in this direction.

In the main, the principle of giving primacy to internal requirements over creditor interests should be implemented. Public resources should be reallocated for vital public spending on infrastructure, the rehabilitation of calamity-struck areas, and social services.

One thing must be made clear, however. An alternative debt policy is only part of a more comprehensive economic program which includes appropriate trade, monetary and industrial policy. The basic thrust of this alternative program is to create a more vigorous internal economy with reduced vulnerability to external shocks. Autarky is not prescribed. Property reform is obviously a key component of this program and will likewise lay the ground for the resolution of the current civil war. Comprehensive reform will be painful and will be the subject of continuing political contests and conflicts. Restructuring our relations with external economic actors in our favor may also invite retaliation and may force us to compromise.

But the pains must be borne and the uncertainties must be braved. Otherwise, the alternative is the continued existence of an economy that will continue to be stunted by debt woes.

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