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## The Philippines: Challenges for Sustaining the Economic Recovery

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# The Philippines: Challenges for Sustaining the Economic Recovery

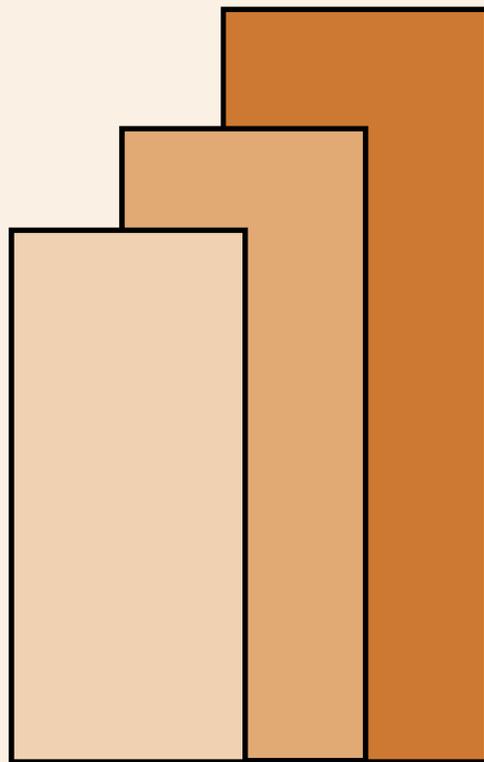
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# **THE PHILIPPINES: CHALLENGES FOR SUSTAINING THE ECONOMIC RECOVERY**

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## **ABSTRACT**

*This paper discusses the performance of the Philippine economy as it recovers from the Asian financial crisis and the challenges the country faces in sustaining the recovery and propelling the economy to a higher growth path. The economy has some strengths, such as relatively healthy financial and corporate sectors, sustained growth in exports, among others, that can serve as a platform for sustaining the growth momentum. However, the authorities must perform two major tasks, which are not altogether new. One is to ensure macroeconomic stability. In this regard, the government must pay particular attention to containing its budget deficit and managing well its foreign and domestic debt. It must also pursue a consistent exchange rate policy to prevent the recurrence of the condition that prevailed before the crisis and reduce the country's risk to sudden shift in short-term capital flows. The other is to continue the structural reforms so that the country can exploit the opportunities created by the globalization of trade and finance. The structural reforms envisioned in the coming years should address the need for the country to develop intermediate industries to support the industrialization process and to deepen the local operations of foreign-owned enterprises as well as strengthen their linkages with local firms.*

# THE PHILIPPINES: CHALLENGES FOR SUSTAINING THE ECONOMIC RECOVERY

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## I. INTRODUCTION

The Philippines seems to be out of place in Asia. Before the Asian financial crisis, the Philippines was usually excluded from studies that analyzed the East Asian miracle because of its lackluster performance in the 1980s and early 1990s. During the financial crisis, the Philippines was again excluded from studies that analyzed the depth and magnitude of the effects of the crisis because it was the least adversely affected economy in the region.<sup>1</sup> Indeed, while severely affected Asian countries were rushing towards the IMF entrance door for a bail-out package at the onset of the crisis, the Philippines, after having been under the IMF tutelage for so long a time, was just starting to move to the IMF exit door with a small exit package. Also, among the Asian countries that tapped the Miyazawa Fund to prop up their economies while the crisis was unfolding, the Philippines got the smallest share.

Interestingly, the euphoria that was felt before the Asian financial crisis seems to have returned quickly to the crisis-hit East Asian economies. Economic forecasters are now even busy revising their forecasts for 1999 and 2000 after the crisis-hit economies had performed better than what were originally expected in the first three quarters of 1999. There seems to be a growing consensus that the crisis-hit economies will exhibit a “V-shaped” pattern of growth, meaning that they can quickly return to their respective pre-crisis growth rates. If this materializes, then there is a possibility that the Philippines will again be excluded from studies on the phenomenal recovery of crisis-hit East Asian economies unless it can successfully steer the economy towards a higher, more durable and stable growth path. It must guard against falling once more into the “W-shaped” pattern of growth it experienced

between 1980 and 1996.<sup>2</sup> The good news is that it is in a position to do it, but it must exploit the strengths that made it more resilient to the regional financial crisis and enhance them further by not delaying anymore the much-needed structural reforms to complement the earlier reform measures.

The next section briefly reviews the major structural reforms the Philippine authorities had put in place before the Asian financial crisis. This is followed by a discussion on the performance of the Philippine economy since the onset of the Asian financial crisis. This section will not only examine key macroeconomic indicators but will also closely scrutinize the financial and corporate sectors, which prominently figured out in discussions dealing with the Asian financial crisis. The fourth section discusses some challenges that the Philippines has to face to sustain the economic recovery and propel it to a much higher growth path. The fifth section concludes the study.

## **II. STRUCTURAL REFORMS UNDERTAKEN**

The Asian financial crisis struck while the Philippines was in the midst of restructuring its economy. It just implemented the third phase of tariff reform program to further improve the efficiency in resource allocation and enhance the competitiveness of local industries in the domestic and export market (see **Table 1**).<sup>3</sup> The highly protected sectors of the economy, such as telecommunications, transport (air, water and land), and the oil industry were deregulated and opened up for new entrants in the 1990s.

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<sup>1</sup> The GDP growth rates for 1998 were: Hong Kong - -5.1%; Indonesia - -13.7%; Korea - -5.5%; Malaysia - -6.2%; Philippines - -0.5%; and Thailand - -8.0%. Were it not for the El Nino weather phenomenon that badly hit the agricultural sector, the Philippines' GDP could have grown in 1998.

<sup>2</sup> There is a real danger that other crisis-hit countries will exhibit the W-shaped pattern of growth if they mismanage their economies during the recovery period.

<sup>3</sup> This already includes the tariff modification on the textiles and garments, petrochemicals, and iron and steel sectors effected in January 1999. According to the Tariff Commission, more than half of the total tariff lines is currently dutiable at 3 percent and another at 31 percent of all lines have tariffs of either 10 percent or 20 percent.

<b>TABLE 1. AVERAGE NOMINAL TARIFFS</b>					
<b>1993 - 2000</b>					
<b>In percent</b>					
<b>Year</b>	<b>Agriculture</b>	<b>Mining</b>	<b>Manufacturing</b>	<b>Overall</b>	<b>Effective Protection Rates</b>
					<b>Overall</b>
1993	36.91	10.62	21.59	23.50	-
1994	32.86	10.79	17.70	19.72	-
1995	27.99	7.31	14.00	15.87	-
1996	28.29	5.11	13.46	15.55	25.43
1997	25.28	4.68	11.45	13.43	21.78
1998	18.91	3.58	9.42	10.69	13.17
1999	16.55	3.53	9.11	10.08	12.21
2000	14.64	3.31	7.16	8.18	10.71

*As of E.O. 63 (15 January 1999)*

*The EPR estimates are based on the refined methodology developed for the Tariff Commission using the 1988 237 x 237 Input-Output Table.*

*Source: Philippine Tariff Commission*

To enhance the role of the private sector in economic development, the government had privatized a large number of government corporations. It also introduced the build-operate-transfer (BOT) scheme to allow greater private sector participation in the financing and implementation of government infrastructure projects.

The Foreign Investment Act (FIA) was passed in 1991, liberalizing entry of foreign investors within the provisions of the Philippine Constitution. As a general rule, there are no restrictions on the extent of foreign ownership of export-oriented enterprises, defined as those exporting at least 60 percent of their total output. As for domestic-oriented enterprises, foreigners are allowed to invest as much as 100 percent, unless the participation is prohibited or limited to a smaller percentage by existing laws and/or the provisions of the FIA. A complementary law was passed allowing foreigners to lease private lands for a total of 75 years.

An important reform measure introduced in the financial sector was the creation of an independent central bank starting with a healthy balance sheet.<sup>4</sup> Aside from this, the monetary authorities sought to enhance competition in the financial

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<sup>4</sup>A large portion of the liabilities of the old central bank were transferred to the central bank board of liquidators or CB-BOL.

system by decontrolling interest rates, lifting the moratorium on opening of new commercial banks and by considerably relaxing the rules on bank branching. Thus, the number of banks and bank branches substantially increased in a matter of five years, providing a greater number of people with access to banking services. Another reform measure introduced in the financial sector was the liberalization of the entry and scope of operations of foreign banks. The law that was passed has provided for the entry of 10 branches of foreign banks and has allowed foreign banks to own up to 60 percent of the total shares of domestic banks. The foreign exchange market was deregulated and several restrictions on foreign exchange transactions were either substantially relaxed or completely removed, making the capital account of the balance of payments much more open than before.<sup>5</sup>

The liberalization, deregulation and privatization had been the driving force behind the growth of corporations in the 1990s. For a few firmly established corporations, easier access to credit from both the domestic and foreign financial institutions had allowed them to expand their operations either in the same line of business or to other lines of businesses. Some of those that had reached their borrowing limits had tapped the capital market for funds by publicly offering new shares and listing them in the local stock exchange. This had attracted foreign funds, which, in turn, boosted prices of local stocks.

Unfortunately, the structural reforms had not been supported by appropriate macroeconomic policy. There was a penchant on the part of the monetary authorities to break the so-called “impossible trinity” by trying to achieve simultaneously exchange-rate stability, monetary independence and financial-market integration.<sup>6</sup> Thus, despite the reforms and the fact that it was a “late bloomer” in Asia, attracting less foreign capital compared to its neighboring economies, still the Philippines was caught, though less severely compared to its neighboring economies, by the contagious Asian flu. The authorities adopted some measures to

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<sup>5</sup> The capital account of the balance of payments is not yet completely convertible because some of the restrictions on foreign exchange transactions are still retained.

<sup>6</sup> Economic theory suggests that only two of these three goals can be simultaneously achieved.

stabilize the economy.<sup>7</sup> More importantly, they have allowed the exchange rate to float freely since July 1997 and pursue the goals of monetary independence and financial-market integration.

### III. RECENT PERFORMANCE OF THE DOMESTIC ECONOMY

#### Macroeconomic Performance

After contracting for three consecutive quarters in 1998, the GDP has started to grow again beginning in the first quarter of 1999 (see **Table 2**). Agriculture, which shrank in 1998 as a result of the El Nino weather phenomenon, has led the recovery. The service sector, which slowed down during the height of the regional financial crisis, has also pulled up GDP, albeit its growth has not yet returned to the pre-crisis levels. The industrial sector, on the other hand, managed to post a small growth only on the third quarter of 1999 as both the construction and mining & quarrying sub-sectors have continued to contract. The bright spot though is the mild recovery experienced by the manufacturing sector beginning in the second quarter of 1999.

	1995			1996			1997			1998			1999						
	Q1	Q2	Q3	Q1	Q2	Q3	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3		
<b>BY EXPENDITURE SHARES</b>																			
Personal Consumption Expenditure	143389	154434	153749	171413	149421	161553	161074	179742	156862	169755	169099	188600	163980	176450	173976	193498	168030	181018	178553
Government Consumption	15959	16755	16384	16582	16766	17706	16974	17081	17526	19002	18018	17157	16582	18552	17783	17263	17850	19696	18438
Capital Formation	48134	44525	36671	56821	52383	51009	49222	57826	60182	54644	53803	66496	56567	44706	43507	51700	51098	47464	41184
Fixed Capital	46702	42391	42696	52878	50973	48259	48732	58890	57739	53921	55536	63466	58318	49037	46268	50656	50309	50121	45012
Construction	19329	18626	19080	21592	21431	22025	22985	24674	25569	25264	26770	26801	26680	24656	23414	23469	22836	25395	23025
Durable Equipment	23929	20703	21428	27641	25929	23105	23356	30264	28157	25118	26307	32483	27722	20761	20377	22977	23615	21027	19460
Breeding Stock & Orchard Dev't.	3444	3062	2188	3645	3613	3129	2391	3952	4013	3539	2459	4182	3916	3620	2477	4210	3858	3699	2527
Changes in Stock	1432	2134	-6025	3943	1410	2750	490	-1064	2443	723	-1733	3030	-1751	-4331	-2761	1044	789	-2657	-3828
Exports	72549	81036	92758	97838	84005	92116	109044	112036	102777	107938	121904	132703	113419	93902	100371	90965	86973	88835	102440
Less: Imports	94493	112428	106935	114619	112391	127186	130678	129939	137427	153291	151177	133099	120190	129283	103658	109286	120637	129494	
Statistical Discrepancy	5212	9988	858	-3714	10586	10971	1208	-1408	231	3732	7380	-7267	-3246	2092	10406	-8168	2076	6870	12282
Net Factor Income From Abroad	4935	3779	6944	6640	9226	9162	9287	7430	9616	9110	10183	8594	10551	10040	11893	10568	12728	10841	12684
<b>BY INDUSTRIAL ORIGIN</b>																			
Agri, Fishery, Forestry	44127	40191	36053	52473	45425	42938	38885	52203	47651	43701	39029	54332	45828	38668	37831	50118	47176	42958	39958
a. Agriculture and Fishery	43847	39639	35739	52092	44866	42464	38325	51898	47342	43329	38820	54110	45566	38341	37660	49981	46951	42695	39817
b. Forestry	280	552	314	381	559	474	560	305	309	372	209	222	262	327	171	137	225	263	141
Industry Sector	66359	68417	72520	77208	70187	72169	77570	82200	73740	77621	82550	86778	73878	77050	80931	82695	72261	76535	81113
a. Mining and Quarrying	2631	3164	2821	2065	2752	2557	2727	2130	2392	2532	2775	2639	2893	2703	2849	2179	2443	2321	2470
b. Manufacturing	46958	47737	51907	56669	49259	50710	55197	59447	50408	53412	57592	62260	51416	52943	56741	60051	50905	53428	58016
c. Construction	11008	10998	10945	11541	11840	12025	12342	13132	14361	14250	14581	14130	12517	13522	13492	12933	11767	12803	12696
d. Elect., Gas and Water	5762	6518	6847	6933	6336	6877	7304	7491	6579	7427	7602	7749	7052	7882	7849	7532	7146	7983	7931
Service Sector	80264	85702	84912	94640	85158	91062	90389	100935	90400	96322	95334	105402	94497	99794	97998	108787	97304	103753	102332
a. Transport, Comm., Storage	11079	12132	11617	12538	11798	13001	12537	13542	12844	14067	13471	14685	13878	14982	14216	15564	14350	15730	15040
b. Trade	26821	29844	30258	36507	28301	31453	31991	38502	29674	32817	33361	39474	30893	33499	33808	40441	31759	34960	35712
c. Finance	8112	8561	8257	8922	9064	9628	9444	10377	10482	10853	10674	11500	11173	11469	11034	11769	11467	11674	11217
d. O. Dwellings & Real Estate	10948	11018	10937	10862	11261	11395	11398	11522	11769	11826	11815	11887	12034	12069	11974	11988	12015	12132	12074
e. Private Services	13296	13919	13771	14475	13926	14557	14572	15176	14575	15273	15353	15839	15189	15940	16037	16714	16078	16831	17044
f. Government Services	10008	10228	10072	11336	10808	11028	10447	11816	11056	11486	10660	12017	11330	11835	10929	12311	11635	12426	11245
<b>Gross Domestic Product</b>	<b>190750</b>	<b>194310</b>	<b>193485</b>	<b>224321</b>	<b>200770</b>	<b>206169</b>	<b>206844</b>	<b>235338</b>	<b>211791</b>	<b>217644</b>	<b>216913</b>	<b>246512</b>	<b>214203</b>	<b>215512</b>	<b>216760</b>	<b>241600</b>	<b>216741</b>	<b>223246</b>	<b>223403</b>
<b>Gross National Product</b>	<b>195685</b>	<b>196089</b>	<b>200429</b>	<b>230961</b>	<b>209996</b>	<b>215331</b>	<b>216131</b>	<b>242768</b>	<b>221407</b>	<b>226754</b>	<b>227096</b>	<b>255106</b>	<b>224754</b>	<b>225552</b>	<b>228653</b>	<b>252168</b>	<b>229469</b>	<b>234087</b>	<b>236087</b>

Source: National Statistical Coordination Board

<sup>7</sup> The response of the authorities to the Asian financial crisis is discussed in detail in Lamberte and Yap (1999).

Government consumption, which contracted in the first three quarters of 1998 as the government instituted austerity measures to contain the budget deficit, rebounded in the first two quarters of 1999 but slowed down in the third quarter. It definitely was the main contributor to the increase in aggregate demand in 1999 as the government tried to reeve up the economy through some pump-priming measures. Personal consumption did not contract in the wake of the financial crisis. However, its growth had considerably decelerated and had remained sluggish during the first three quarters of 1999. In contrast, capital formation had been contracting since the first quarter in 1998, except in the second quarter of 1999.

The current account balance, which historically had been negative, turned positive in 1998 and the first half of 1999. This can be attributed both to the decline in imports as the economy slowed down and to the continued growth in exports (see **Table 3**). Despite the regional crisis, exports had managed to grow by 17 percent in 1998 and 14 percent during the first seven months of 1999, which can be mainly accounted for by the rapid growth in manufactured exports. Access of export-oriented enterprises to credit had not been impaired during the crisis period.

Quarter	1996				1997				1998				1999	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
<b>Balance of Payments</b>	<b>889</b>	<b>1,527</b>	<b>1,333</b>	<b>358</b>	<b>570</b>	<b>(779)</b>	<b>(998)</b>	<b>(2,156)</b>	<b>617</b>	<b>942</b>	<b>22</b>	<b>(222)</b>	<b>1,947</b>	<b>930</b>
<b>Current Account, Net</b>	<b>(777)</b>	<b>(1,949)</b>	<b>(43)</b>	<b>(1,184)</b>	<b>(519)</b>	<b>(1,652)</b>	<b>(1,461)</b>	<b>(719)</b>	<b>(85)</b>	<b>97</b>	<b>427</b>	<b>848</b>	<b>1,324</b>	<b>926</b>
Trade	(949)	(2,103)	(232)	(1,258)	(767)	(1,897)	(1,762)	(1,005)	(272)	(43)	347	820	1,216	809
Goods, Net	(2,671)	(3,376)	(2,713)	(2,582)	(2,893)	(2,764)	(3,081)	(2,389)	(1,085)	(253)	512	798	548	148
Exports	4,685	4,897	5,344	5,617	5,506	6,194	6,663	6,865	6,816	7,089	7,940	7,651	7,853	7,950
Imports	7,356	8,273	8,057	8,199	8,399	8,958	9,744	9,254	7,901	7,342	7,428	6,853	7,305	7,802
Services, Net	1,722	1,273	2,481	1,324	2,126	867	1,319	1,384	813	210	(165)	22	668	661
Receipts	3,952	4,269	5,557	5,228	5,896	5,202	5,913	5,824	4,671	3,128	2,662	3,456	3,476	3,426
Payments	2,230	2,996	3,076	3,904	3,770	4,335	4,594	4,440	3,858	2,918	2,827	3,434	2,808	2,765
Transfers, Net	172	154	189	74	248	245	301	286	187	140	80	28	108	117
Inflow	236	242	273	434	401	402	412	455	325	182	124	127	130	143
Outflow	64	88	84	360	153	157	111	169	138	42	44	99	22	26
<b>Capital and Financial Account, Net</b>	<b>2,272</b>	<b>3,698</b>	<b>3,361</b>	<b>1,744</b>	<b>2,732</b>	<b>3,070</b>	<b>1,892</b>	<b>(1,101)</b>	<b>811</b>	<b>1,891</b>	<b>(1,294)</b>	<b>(452)</b>	<b>1,710</b>	<b>684</b>
Medium and Long-Term Loans, Net <sup>2/</sup>	181	984	1,036	640	1,291	1,055	1,720	758	689	1,699	196	266	2,226	(207)
Availments	986	1,763	1,693	2,098	2,012	1,818	2,216	1,678	1,071	2,595	870	1,255	2,951	587
Repayments	805	779	657	1,458	721	763	496	920	382	896	674	989	725	794
Trading of Bonds in the Secondary Market	110	(216)	78	(9)	(177)	(167)	(139)	(193)	(89)	(251)	(164)	(578)	(238)	54
Resale of Bonds	1,264	737	1,138	1,009	943	826	704	599	620	658	1,254	776	941	1,068
Purchase of Bonds	1,154	953	1,060	1,018	1,120	993	843	792	709	909	1,418	1,354	1,179	1,014
Investments, Net	930	819	1,060	708	1,001	(231)	(25)	17	521	187	(133)	1,097	627	487
Non-Resident Investments in the Phils.	913	883	1,114	711	945	(214)	32	80	622	265	(45)	1,174	795	524
Resident Investments Abroad	(17)	64	54	3	(56)	17	57	63	101	78	88	77	168	37
Short-Term Capital, Net	188	26	164	162	264	(25)	132	124	(589)	(238)	(153)	(541)	61	(1,180)
Change in Commercial Banks' NFA <sup>3/</sup>	863	2,085	1,023	243	353	2,438	204	(1,807)	279	494	(1,040)	(696)	(966)	1,530
Purchase of Collateral	.	.	.	.	.	.	.	.	.	.	.	.	.	.
<b>Others</b>	<b>52</b>	<b>(46)</b>	<b>14</b>	<b>(25)</b>	<b>(181)</b>	<b>59</b>	<b>(56)</b>	<b>(182)</b>	<b>53</b>	<b>(45)</b>	<b>88</b>	<b>-</b>	<b>81</b>	<b>(48)</b>
Monetization of Gold	53	50	55	40	(4)	32	33	44	10	46	47	15	35	42
Revaluation Adjustments	(1)	(96)	(41)	(65)	(177)	27	(89)	(226)	43	(91)	41	(15)	46	(90)
Net Unclassified Items	(658)	(176)	(1,999)	(177)	(1,462)	(2,256)	(1,373)	(154)	(162)	(1,001)	801	(618)	(1,168)	(632)
Basic Balance <sup>4/</sup>	777	1,336	2,500	(173)	1,690	2,034	713	(1,663)	1,101	2,495	(267)	1,437	3,021	2,368

Notes :

1 For 1996 and 1997, adjusted NSO data exclude the US\$542M worth of aircraft under operational lease in 1996 and US\$45M worth of aircraft under operational lease arrangement in A

2 For 1996, revised as of 2 Mar 1998 to reflect adjustments in MLT.

3 Revised as of 7 Aug 1997 to exclude resident transactions in FCDs, bills payable and other foreign monetary assets.

4 The sum of current account balance, net MLT loans, net direct investments and change in net foreign asset position of commercial banks (NFA).

Source: Bangko Sentral ng Pilipinas

Increasing market diversification had contributed to the resiliency of Philippine exports. As **Table 4** shows, the combined shares of the two largest export markets, i.e., USA and Japan, had declined from 57.6 percent to 48.6 percent over the period 1990 to 1998. In contrast, the shares of three European countries, namely, Netherlands, UK and Germany, together rose from 13.4 percent to 17.3 percent during the same period. Interestingly, the combined shares of Philippine exports to its Asian neighbors, namely Singapore, Taiwan, Hong Kong, Malaysia and Thailand, rose from 13 percent to 23 percent during the indicated period. Singapore and Taiwan, which did well during the regional financial crisis, posted significant increases in the shares of Philippine exports. The expected rapid recovery of the crisis-hit neighboring countries bodes well for the Philippines' exports in the coming years.

**TABLE 4. EXPORTS BY DESTINATION AND IMPORTS BY ORIGIN**  
Annual Data: 1990 to 1998  
In million US dollars

Country	1990		1991		1992		1993		1994		1995		1996		1997		1998	
	% Share																	
<b>EXPORTS</b>																		
<b>TOTAL</b>	<b>8,186</b>	<b>100.00</b>	<b>8,840</b>	<b>99.99</b>	<b>9,824</b>	<b>100.00</b>	<b>11,375</b>	<b>100.00</b>	<b>13,483</b>	<b>100.00</b>	<b>17,447</b>	<b>100.00</b>	<b>20,543</b>	<b>100.00</b>	<b>25,228</b>	<b>100.00</b>	<b>29,496</b>	<b>100.00</b>
1 United States of America <sup>1/</sup>	3,095	37.80	3,144	35.56	3,832	39.00	4,371	38.43	5,143	38.14	6,160	35.31	6,966	33.91	8,815	34.94	10,100	34.24
2 Japan <sup>2/</sup>	1,622	19.81	1,771	20.04	1,745	17.77	1,827	16.06	2,035	15.09	2,747	15.75	3,668	17.86	4,192	16.62	4,228	14.33
3 Netherlands	357	4.36	338	3.83	406	4.14	362	3.18	516	3.83	805	4.61	1,115	5.43	1,663	6.59	2,319	7.86
4 Singapore	240	2.93	229	2.60	252	2.57	379	3.34	710	5.27	996	5.71	1,224	5.96	1,621	6.43	1,832	6.21
5 United Kingdom of Great Britain	351	4.28	372	4.20	467	4.75	541	4.75	639	4.74	923	5.29	937	4.56	1,086	4.30	1,757	5.96
6 Taiwan	209	2.56	210	2.37	287	2.92	346	3.04	453	3.36	568	3.26	661	3.22	1,169	4.63	1,756	5.95
7 Hong Kong	330	4.04	392	4.43	464	4.72	548	4.82	651	4.83	824	4.72	868	4.23	1,171	4.64	1,326	4.50
8 Malaysia <sup>3/</sup>	127	1.55	123	1.39	128	1.30	161	1.42	224	1.66	315	1.81	687	3.34	640	2.54	1,141	3.87
9 Germany	391	4.77	502	5.68	522	5.31	586	5.15	665	4.93	699	4.01	847	4.12	1,060	4.20	1,035	3.51
10 Thailand	156	1.91	221	2.50	98	1.00	169	1.48	364	2.70	799	4.58	780	3.80	856	3.39	634	2.15
11 Others	1,309	15.99	1,537	17.39	1,624	16.53	2,085	18.33	2,083	15.45	2,610	14.96	2,790	13.58	2,955	11.71	3,368	11.42
<b>IMPORTS</b>																		
<b>TOTAL</b>	<b>12,206</b>	<b>100.00</b>	<b>12,051</b>	<b>100.00</b>	<b>14,519</b>	<b>100.00</b>	<b>17,597</b>	<b>100.00</b>	<b>21,333</b>	<b>100.00</b>	<b>26,391</b>	<b>100.00</b>	<b>31,885</b>	<b>100.00</b>	<b>36,355</b>	<b>100.00</b>	<b>29,524</b>	<b>100.00</b>
1 United States of America <sup>1/</sup>	2,366	19.38	2,426	20.13	2,620	18.05	3,522	20.02	3,941	18.47	4,868	18.45	5,911	18.54	7,154	19.68	6,424	21.76
2 Japan <sup>2/</sup>	2,259	18.50	2,373	19.69	3,087	21.26	4,037	22.94	5,190	24.33	5,957	22.57	7,129	22.36	7,414	20.39	6,031	20.43
3 Netherlands	170	1.39	144	1.20	180	1.24	237	1.35	279	1.31	318	1.21	331	1.04	510	1.40	222	0.75
4 Singapore	487	3.99	455	3.78	551	3.79	978	5.56	1,441	6.75	1,553	5.89	1,740	5.46	2,171	5.97	1,742	5.90
5 United Kingdom of Great Britain	248	2.03	215	1.78	300	2.06	379	2.15	389	1.82	549	2.08	479	1.50	545	1.50	319	1.08
6 Taiwan	806	6.60	825	6.84	960	6.61	1,025	5.83	1,226	5.75	1,437	5.44	1,598	5.01	1,808	4.97	1,414	4.79
7 Hong Kong	555	4.54	596	4.95	721	4.96	877	4.98	1,113	5.22	1,275	4.83	1,360	4.27	1,549	4.26	1,300	4.40
8 Malaysia <sup>3/</sup>	272	2.23	298	2.47	387	2.67	356	2.02	431	2.02	573	2.17	801	2.51	947	2.60	943	3.19
9 Germany	538	4.41	465	3.86	670	4.61	613	3.49	761	3.57	929	3.52	1,209	3.79	1,180	3.25	851	2.88
10 Thailand	137	1.12	94	0.78	138	0.95	171	0.97	197	0.92	396	1.50	602	1.89	791	2.18	792	2.68
11 Others	4,369	35.80	4,160	34.52	4,905	33.79	5,401	30.69	6,365	29.84	8,536	32.34	10,725	33.64	12,286	33.79	9,486	32.13

<sup>1/</sup> includes Alaska and Hawaii

<sup>2/</sup> includes Okinawa

<sup>3/</sup> includes Sabah and Sarawak

Components may not add up to total due to rounding

Source: National Statistics Office

The capital account balance has improved since 1998, which can be attributed to the increased availments of medium and long-term loans and the return of foreign investment into the country (see **Table 3**). In 1998, net foreign direct investment inflows amounted to US\$1.75 billion, up from US\$1.25 billion in the preceding year.

Likewise, net portfolio inflows amounted to US\$264 in 1998, which is a reversal to the net portfolio outflows of US\$406 in the previous year. The data for the first seven months of 1999 suggest that the return of foreign investments into the country will likely continue for the rest of the year.

The favorable balance of payments enjoyed by the economy in the last two years has enabled the Bangko Sentral to build up its international reserves. As of September 1999, the gross international reserves stood at US\$14.5 billion, which is equivalent to more than four months of imports.

Total foreign exchange liabilities stood at US\$48.6 billion in March 1999, which was about US\$7 billion higher than the 1996 level. As a percent of GNP, foreign exchange liabilities rose sharply in 1997 to 72 percent, which can be attributed to three factors, namely, increase in foreign exchange liabilities in dollar terms, sharp depreciation of the peso and the very slim GNP growth. However, the ratio has shown some improvements in the most recent period as the economy started to recover.

The maturity structure of foreign exchange liabilities has improved considerably in recent periods (see **Table 5**). As of March 1999, short-term external debt accounted for only 14 percent of the total foreign exchange liabilities, down from 18.6 percent in 1997. As a ratio to gross international reserves, short-term external debts declined from 0.98 in 1997 to 0.67 in 1998 and to 0.53 in March 1999.

After deteriorating in 1997, debt-service burden has started to improve in 1998. It amounted to about 22 percent of the total merchandise and non-merchandise exports during the first seven months of 1999.

The consolidated public sector deficit deteriorated sharply in the wake of the regional financial crisis. From less than 1 percent of GNP in 1997, it rose to 2.98 percent in 1998 (see **Table 6**). During the first half of 1999, the deficit already reached 4.4 percent of GNP as a result of the government's expansionary fiscal stance and failure to meet its revenue target. The increased borrowings resorted to by the government to finance its deficits raised its total outstanding debt to almost P2 trillion

Item	1990		1991		1992		1993		1994		1995		1996		1997		1998		Mar 1999	
	Share	Share																		
Medium and Long Term <sup>1/</sup>	24,173	85	25,129	84	25,678	83	29,247	85	31,882	86	32,499	86	34,668	83	36,994	81	40,632	85	41,849	86
Short Term	4,376	15	4,827	16	5,256	17	5,035	15	5,197	14	5,279	14	7,207	17	8,439	19	7,185	15	6,787	14
Trade	4,099	14	4,589	15	4,937	16	3,495	10	3,401	9	2,674	7	4,096	10	4,032	9	2,551	5	2,367	5
Non - Trade	277	1	238	1	319	1	1,540	4	1,796	5	2,605	7	3,111	7	4,407	10	4,634	10	4,420	9
<b>Total</b>	<b>28,549</b>	<b>100</b>	<b>29,956</b>	<b>100</b>	<b>30,934</b>	<b>100</b>	<b>34,282</b>	<b>100</b>	<b>37,079</b>	<b>100</b>	<b>37,778</b>	<b>100</b>	<b>41,875</b>	<b>100</b>	<b>45,433</b>	<b>100</b>	<b>47,817</b>	<b>100</b>	<b>48,636</b>	<b>100</b>
% of GNP	74.61		63.63		56.47		63.29		52.14		50.56		48.68		71.99		66.84			
GIR	1,993		4,470		5,218		5,802		6,995		7,633		11,620		8,650		10,684		12,832	
Months of Imports of Goods and Services	1.50		3.40		3.40		3.10		3.10		2.60		3.20		1.90		2.90		3.80	
Ratio of Short Term Debt to GIR	2.20		1.08		1.01		0.87		0.74		0.69		0.62		0.98		0.67		0.53	
Debt-Service as % of exports	2,700		2,828		2,336		3,973		2,892		3,455		5,047		7,391		5,366		4,461	a/
as % of merchandise & non-mer. exports	32.98		31.99		23.78		34.93		21.45		19.80		24.57		29.30		18.19		23.91	
	30.25		27.31		18.19		28.62		16.58		15.55		18.46		23.90		17.67		22.18	

Notes:

<sup>1/</sup> Effective July 3, 1993, accounts of old CB were split between Bangko Sentral ng Pilipinas & Central Bank - Board of Liquidators.

a/ Jan-Jul 1999

Source: Bangko Sentral ng Pilipinas

as of August 1999, which is roughly equivalent to 65 percent of GNP.<sup>8</sup> To relieve pressure on the domestic interest rate, the government opted to fund its growing deficit by borrowing abroad. This has led to a substantial increase in the share of

YEAR	National Government % of GNP		Total Surplus / (Deficit) % of GNP	
1990	(37.19)	(3.47)	(51.02)	(4.76)
1991	(26.35)	(2.10)	(25.90)	(2.06)
1992	(15.97)	(1.16)	(26.03)	(1.89)
1993	(21.89)	(1.46)	25.90	1.73
1994	16.29	0.94	(8.30)	(0.48)
1995	11.07	0.57	(4.10)	(0.21)
1996	6.26	0.28	7.30	0.32
1997	1.56	0.06	(24.10)	(0.96)
1998	(50.00)	(1.79)	(83.20)	(2.98)
Jan-Jun 1999	(52.50)	(3.56)	(64.90)	(4.40)

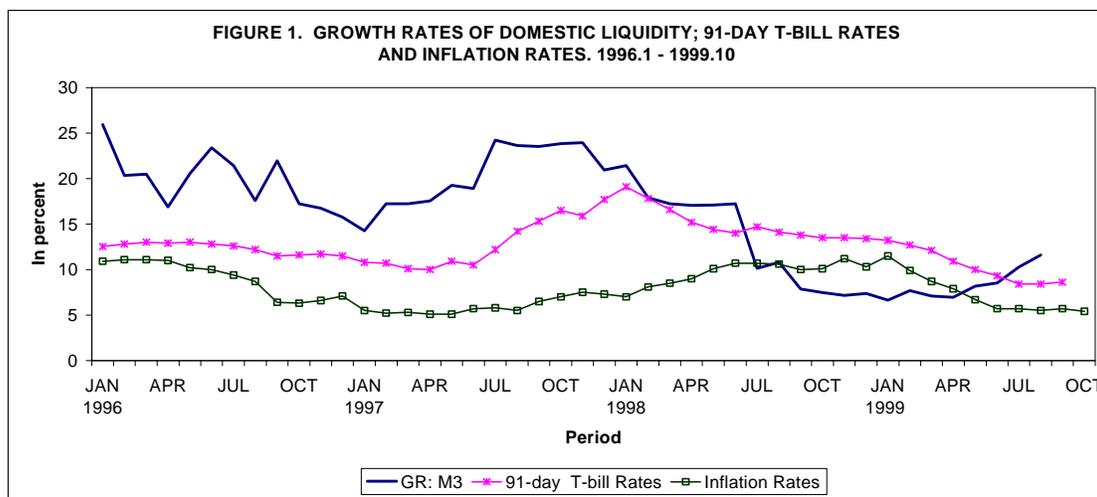
Source: Department of Finance

<sup>8</sup> The total outstanding debts include both real and contingent liabilities of the national government and government corporations.

the government's foreign currency denominated debt. As of August 1999, the public sector foreign currency denominated debt comprised about 53 percent of the total public sector debt. The bright point though is that the government has been gradually shifting the maturity structure of its domestic debt towards medium and long-term (i.e., with a maturity of 2 years or more), which currently represents roughly one-third of its total outstanding domestic debt.

Slowing the growth in liquidity (M3) was one of the measures adopted by the Bangko Sentral to ensure that inflation is maintained at reasonable levels during the recovery period (see **Figure 1**). Inflation accelerated in 1998 mainly as a result of shortages in food supply caused by the El Nino weather phenomenon. Since then, inflation rate has been brought down to single digit level, posting at 5.4 percent on a year-on-year basis in October 1999.

The favorable movements of prices in recent months have partly contributed to the decline in the domestic interest rates.<sup>9</sup> The 91-day Treasury bill rate, which



rose to more than 20 percent in January 1998, slid down to less than 10 percent in 1999. In the last auction date, it stood at around 8.8 percent per annum.

<sup>9</sup> As mentioned earlier, the government's reliance on foreign loans to finance the budget deficit partly contributed to the decline in the interest rate. Another contributory factor is the increasing liquidity of

The exchange rate, which has been allowed to float freely since July 1997, has remained relatively stable at around P39-P41 to a dollar, except in some periods when the entire region experienced some pressure on their exchange rates.<sup>10</sup>

### **The Financial Sector**

After posting an average growth of 50 percent between the first quarter of 1995 and the second quarter of 1997, growth in commercial bank loans dropped precipitously in the aftermath of the Asian financial crisis (see **Figure 2**). In fact, commercial bank loans have been contracting since the fourth quarter of 1998. In contrast, deposits at commercial banks have continued to grow, although at a much lower rate. Foreign-currency denominated loans of the foreign currency deposit units (FCDUs) of banks, which peaked at US\$10.8 billion in 1996, declined to US\$7.2 billion in June 1999. On the other hand, foreign currency deposits have remained stable and stood at US\$15 billion in June 1999.<sup>11</sup> All this suggests that depositors' confidence in the banking system has remained firm during the crisis period.

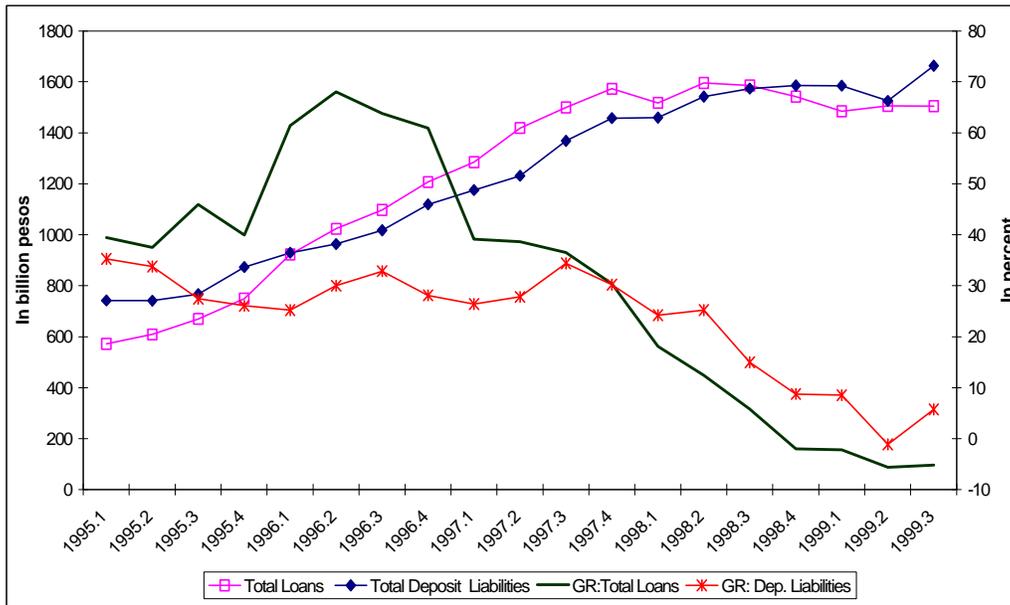
Nonetheless, the effects of the Asian financial crisis on the domestic economy have somewhat weakened the balance sheets of banks. In particular, the non-performing loans of commercial banks rose from 2.8 percent of their total loans in December 1996 to 14.4 percent in August 1999 (see **Figure 3**). Because of the rise in NPLs, banks have worked out arrangements with distressed borrowers to engage in voluntary restructurings, in most cases taking a haircut. In some hopeless cases, banks went into foreclosure proceedings, which led to the rise in the other properties owned/acquired (ROPOA) item in their balance sheets. If the ROPOA were added to the NPLs, then the total non-performing loans of commercial banks should have already reached almost twenty percent. Though high, still it is lower than the NPLs of commercial banks during the height of the crisis in the mid-1980s and compares favorably with those of crisis-hit countries in the ASEAN region. Also, banks are compelled to add loan loss provisions to cover potential losses from NPLs.

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banks resulting from the continued increase in deposits and depressed demand for loans (cf. discussion below).

<sup>10</sup> The newly installed Governor of the Bangko Sentral preferred not to intervene in the foreign exchange market during the most recent exchange rate volatility.

**FIGURE 2. COMMERCIAL BANKS' TOTAL LOANS & TOTAL DEPOSIT LIABILITIES AND THEIR GROWTH RATES**  
 Quarterly Data: 1995.1 to 1999.3



Year		Total Loans of KBs in B P	Total Deposit Liabilities in B P	GR: Total Loans	GR: Dep. Liabilities	
1995	1995.1	571.899	742.64	39.47	35.29	
	1995.2	608.781	741.17	37.50	33.77	
	1995.3	670.346	766.52	45.96	27.45	
	1995.4	749.970	873.83	39.95	26.08	
1996	1996.1	923.217	929.90	61.43	25.22	
	1996.2	1,023.250	963.73	68.08	30.03	
	1996.3	1,098.050	1,018.28	63.80	32.85	
	1996.4	1,206.614	1,119.56	60.89	28.12	
1997	1997.1	1,284.591	1,175.46	39.14	26.41	
	1997.2	1,418.953	1,232.09	38.67	27.85	
	1997.3	1,499.248	1,368.35	36.54	34.38	
	1997.4	1,573.140	1,457.91	30.38	30.22	
1998	1998.1	1,517.632	1,460.22	18.14	24.23	
	1998.2	1,595.372	1,542.58	12.43	25.20	
	1998.3	1,586.250	1,573.45	5.80	14.99	
	1998.4	1,542.487	1,586.09	(1.95)	8.79	
1999	1999.1	1,484.459	1,585.11	(2.19)	8.55	
	1999.2	1,505.595	1,525.60	(5.63)	(1.10)	
	1999.3	a/ 1,504.435	1,663.50	(5.16)	5.72	
		<b>Average Growth Rates</b>				
				1995.1- 1997.2	49.49	29.31
				1997.3 - 1999.3	9.82	16.78

a/ As of end-August 1999

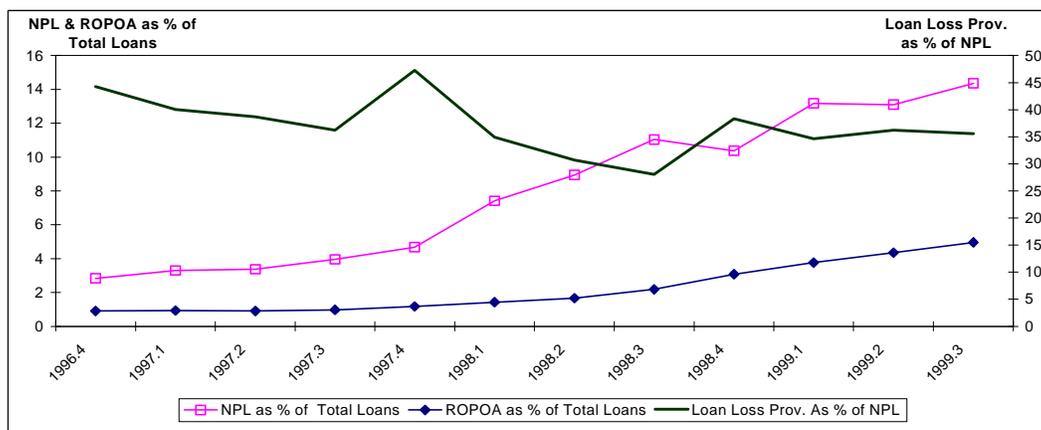
b/ The total deposit liabilities for 1999.2 and 1999.3 were directly obtained from published balance sheets of banks.

Source: Bangko Sentral ng Pilipinas

Due to several upward revision of the required minimum capital and the relative conservativeness of major banks, the commercial banking system's capital adequacy ratio has remained high, reaching about 18 percent in May 1999. Thus, the

<sup>11</sup> What is interesting to note is that about 85 percent of FCDU deposits are owned by residents, which

**FIGURE 3. ROPOA, TOTAL LOANS, LOAN LOSS PROVISIONS AND NPL OF COMMERCIAL BANKS**  
 Quarterly Data: 1996.4 to 1999.3



Year	Total Loans	NPL % of Total Loans	ROPOA, Net % of Total Loans	Loan Loss Provisions % of NPL				
1996	1996.4	1,206,614	34,206	2.83	10,898	0.90	15,149	44.29
1997	1997.1	1,284,591	42,319	3.29	11,900	0.93	16,939	40.03
	1997.2	1,418,953	47,856	3.37	12,840	0.90	18,517	38.69
	1997.3	1,499,248	59,399	3.96	14,687	0.98	21,517	36.22
	1997.4	1,573,140	73,602	4.68	18,407	1.17	34,780	47.25
1998	1998.1	1,517,632	112,601	7.42	21,752	1.43	39,313	34.91
	1998.2	1,595,372	142,731	8.95	26,469	1.66	43,776	30.67
	1998.3	1,586,250	175,109	11.04	34,655	2.18	49,175	28.08
	1998.4	1,542,487	160,001	10.37	47,535	3.08	61,333	38.33
1999	1999.1	1,484,459	195,635	13.18	55,828	3.76	67,740	34.63
	1999.2	1,505,595	197,251	13.10	65,597	4.36	71,508	36.25
	1999.3	1,504,435	216,059	14.36	74,651	4.96	76,794	35.54

a/As of end-August 1999

Data on ROPOA for 1999.2 and 1999.3 were directly obtained from published balance sheets of banks.

Source: Bangko Sentral ng Pilipinas

the Philippine commercial banking system has never felt any systemic weakness similar to those experienced by crisis-hit countries in the region during the height of the regional financial crisis.

The Bangko Sentral has recently raised the minimum capital requirement for banks on staggered basis to be completed by 2000 to strengthen further their balance sheets and to induce them into consolidation/merger. Indeed, there were already several bank mergers/consolidations/acquisitions since 1997 (see **Table 7**). However, the mega-mergers that took place recently seem to suggest that banks do not only want to hurdle the new minimum capital requirement or to achieve bigness but also want to broaden market reach and improve the depth and breadth of their range of

can be considered as secondary reserves.

services to be able to gain competitiveness as they participate in the process of globalization.

### **Corporate Sector**

Between January 1997 and August 1999, 5,814 establishments (incorporated and single proprietorships/partnerships) resorted to closure/retrenchments due to economic reasons. Of this, 21 percent were permanently closed. Half of the incidence of closures occurred in 1998, the height of the Asian financial crisis.

Focusing on the corporate sector alone, the SEC reported that 360 companies have so far been dissolved since 1997 of which 86 percent have capital of P1 million or less. Only 14 corporations that were dissolved had P10 million or more in capital.

Philippine corporations are less indebted compared to those of its neighboring countries. This is because they had less access to both the domestic and foreign capital markets compared to those of other countries in the region. Although they rely mostly on banks as external sources of funds, they prefer to bank more on internally generated funds due to high interest rates on loans. Also, since ownership of most Philippine corporations is highly concentrated, there is less principal-agent problem that sometimes leads to high leveraging of capital to generate high profits in the short-term.

The average debt-equity ratio of the top 5000 corporations in the country declined dramatically from 3.63 in 1997 to 2.14 in 1998 (see **Table 8**). For the manufacturing sector, the ratio decreased from 1.99 to 1.36 over the same period. Corporations reacted to the financial crisis by slowing the growth in their liabilities and at the same time increasing their equity by raising capital from their existing owners and/or by inviting foreign partners into their business. Other corporations sold off their “non-core” assets to raise cash and also to focus on their core competencies.<sup>12</sup>

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<sup>12</sup> A case in point is San Miguel Corp.

**TABLE 7. RECENT BANK MERGERS IN PHILIPPINE BANKING**

<b>Date</b>	<b>Banking Institutions Involved</b>	<b>Remarks</b>
October 1999	BPI merges with Far East Bank	BPI initially bought into 17 percent of FEBTC but after a meeting between the shareholders of the two banks, it was agreed that they would merge with the former owning 2/3 of the merged bank, the remaining 1/3 would remain in the hands of FEBTC investors; the merger is the biggest in the Philippines to date and its capitalization will surpass MBT's.
	MBT poised to take over Unionbank	There are speculations that MBT is prepared to buy into Unionbanker after it was dislodged from its no. 1 spot by the merger between BPI and FEBTC; Ramcar Inc., a Unionbank investor unloaded its stocks in the bank reportedly in favor of the Social Security System (SSS); rumors are that MBT may buy the shares from SSS.
July 1999	MBT buys into 70 percent of Philippine Banking Corp. to merge it with its subsidiary Global Business Bank	MBT finalized the agreement through a special block sale in August; plans are afoot to sell the bank's head office along Ayala Avenue.
	United Overseas Bank (UOB) acquires 60 percent of Westmont Bank	UOB may be asked to assume Westmont Bank's emergency loans from the rehabilitation of Associated Bank; the purchase price was at P3 billion; UOB intends to become a premier regional bank with strengths in consumer banking, trade finance and treasury.
June 1999	ABN-Amro buys into Great Pacific Bank of the Yuchengco Group	ABN-Amro said the acquisition was in line with its strategy to expand in the region. The acquisition made the ABN-Amro the largest foreign bank in terms of branch network.
May 1999	Equitable Bank buys majority stake in PCIBank	Equitable Bank plans to issue new shares to double its existing capital to complete its merger with PCIBank; PCIBank is expected to surrender its banking license. It has already delisted from the Philippine Stock Exchange. The merger will also entail the reconstitution of its board to include representatives from the SSS and the Government Service Insurance System.
April 1999	Bank of Commerce (BoC) announces its merger with Traders Royal Bank (TRB)	BoC has asked the Bangko Sentral for P1.5 billion in assistance to wipe out TRB's bad loans.
December 1998	Prudential Bank and Pilipinas Bank announce merger	Prudential Bank doubled authorized capital stock to P1.15 billion to acquire Pilipinas Bank.
	Philippine Bank of Communications announces merger talks with Asian Banking Corporation	Talks between the two banks collapse on the back of valuation concerns; PBCom and Asianbank are now being eyed by banks for a possible acquisition.
	Equitable Bank buys into Ecology Savings and Mortgage Bank	The integration of Ecology Bank branches and personnel is in process.
April 1998	RCBC buys into Capitol Development Bank	Capitol Bank branches have been converted to RCBC Savings Bank branches.
	Equitable Bank buys into Mindanao Development Bank	Integration of Mindanao Development Bank branches has been completed.
September 1997	Development Bank of Singapore (DBS) buys into Bank of Southeast Asia	DBS Bank Philippines has increased its authorized capital stock to P3 billion from P2 billion.
May 1997	Keppel Group of Singapore buys into Monte de Piedad Savings and Mortgage Bank	Keppel Monte Bank is actively pursuing the retail sector.

Source: Thomson Financial BankWatch Research

But the average debt-equity ratios hide the weaknesses of some highly leveraged corporations that encountered financial problems in the wake of the Asian

Major Industry Group	Net Income		Net Profit Margin		Debt-Equity Ratio	
	1997	1998	1997	1998	1997	1998
<b>All Industries</b>	<b>152,662</b>	<b>142,479</b>	<b>18.13</b>	<b>21.73</b>	<b>3.63</b>	<b>2.14</b>
Agriculture, Fishery and Forestry	(974)	1,106	(32.15)	31.02	2.19	0.97
Mining and Quarrying	(2,219)	(776)	(5.58)	(16.44)	0.78	0.78
Manufacturing	(2,475)	57,306	(476.71)	24.18	1.99	1.36
Public Utilities	16,303	15,374	11.06	14.71	3.01	2.74
Construction	2,756	(43)	29.40	(1,724.33)	2.81	3.03
Wholesale and Retail Trade	3,547	3,431	136.10	151.61	3.01	3.31
Transportation and Communication	8,185	(15,935)	17.18	(10.90)	1.71	2.84
Financing, Insurance, Real Estate and Business Services	116,447	72,846	5.27	8.53	2.38	2.30
Community, Social and Personal Services	11,092	9,170	4.13	5.15	1.33	1.05

Source: Securities and Exchange Commission

financial crisis. Due to their inability to service their liabilities, 66 corporations sought refuge from the SEC by applying for a suspension of debt payments since January 1997 (see **Table 9**). Twenty-five of them belong to the top 7000 corporations in the country in terms of their gross revenues in 1996. Of the 66 corporations, 37 cases are still on-going, with most of their creditors demanding outright foreclosure or greater participation in rehabilitation programs. The rest were either withdrawn by the applicants or dismissed by the SEC for lack of merit. It appears that SEC took much longer time to decide on the cases in 1997 than in later years, which could have contributed to the deterioration in the assets of these corporations.

**TABLE 9. CASES INVOLVING SUSPENSION OF PAYMENTS FILED WITH SEC  
January 1997 to September 9, 1999**

Year Filed	Withdrawn	Duration of the Case	Dismissed	Duration of the Case	On-going	Started	Total
1997	1 Auto Brands Corporation	1-yr & 10-mo	1 Structural Steel Forms, Inc.	1-yr & 4-mo	1 Gerry Alcantara Shoes, Inc.		
	2 Duvaz Corporation	1-yr & 4-mo	2 Core Construction and Development Corp.	1-yr & 5-mo	and Bandolino Shoe Corporation	6/19/97	
			3 Victoria C. Alcantara, et al. (Family Plans)	6-mo	2 Mauritius Pulp & Paper Packaging	6/26/97	
			4 North Negros Marketing Co., Inc.	5-mo	Corp. (MPPPC), et al.		
			5 Essence Home Development Corp., et al.	2-yr & 6-mo	3 Victoria's Milling Co., Inc.	7/4/97	
			6 Eduarosa Realty and Development Corp.	2-yr & 5-mo	4 G.G. Sportswear Manufacturing Corp.	8/29/97	
			7 Rominart Manufacturing and Merchandising, Inc.	1-yr & 4-mo	5 Nikon Industrial Corporation,	9/16/97	
			8 Agusan River Enterprises Corporation	1-yr & 1-mo	Nikolite Industrial Corporation'		
			9 Dragon Lady Industries, Inc.	1-yr & 5-mo	2000 Industries Corporation'		
			10 Ohayo Plastic Products Corporation	1-yr & 9-mo	Trade Hope Industrial Corporation,		
			(Formerly Ohayo Plastic Products Co.)		First Uni-Brands Food Corporation,		
		11 Universal Construction Corporation	1-yr & 9-mo	Integral Steel Corporation,			
				Clarion Printing House, Inc.,			
				Nikon Plaza, Inc.,			
				Niko Land Corporation,			
				Eyco Properties, Inc.,			
				Thames Philippines, Inc.			
				6 HSC Management and Development Corp.	12/11/97		
<b>Total</b>	<b>2</b>		<b>11</b>		<b>6</b>		<b>19</b>
1998	1 A & T Incorporated	15-day	1 Talsan Enterprises, Incorporated	2-mo & 9-day	1 Oranbo Realty Corporation	2/2/98	
	2 Transpacific Towage, Inc.	11-day	2 Financiera Manila, Inc.,	2-mo & 12-day	2 Duty Free First Superstore, Inc.	2/16/98	
	3 Paper City Corporation of the Phils.	1-yr & 4-mo	Growth Dimensions International, Inc.,		3 Midas Diversified Export Corporation,	2/16/98	
	4 Solid Builders, Inc. and Medina Foods Industries, Inc.	3-mo & 4-day	3 Costa Mesa Development, Inc.	3-mo & 3-day	Manila Home Textile Inc.,		
	5 Mountain Highway Express, Inc.	3-mo & 8-day	4 Pacific Lenders, Inc.	3-mo & 1-day	D and D Manufacturing, Inc.,		
				4 Manufacturers Associates, Inc.	FL Industrial Corporation,		

Year Filed	Withdrawn	Duration of the Case	Dismissed	Duration of the Case	Ongoing	Started	Total
			5 Visual Realities, Inc.	3-mo & 23-day	Louisville Realty and Development Corp.		
			6 James Kennedy Lugooc	1-mo & 28-day	4 Anva Land Development Corporation	2/27/98	
			7 Pratrium Holdings, Inc.	3-mo & 2-day	5 Brightstar Tropical Fruits Phils., Inc.	3/13/98	
			8 Serg's Products, Inc.	8-mo	6 Fieldman Cotton Center Corporation	3/26/98	
			9 Benwin Realty and Development Corp.	3-mo & 10-day	7 Lucky Homes Realty and Dev't. Corp.	4/2/98	
			10 Hammen Industries Corp., Inc.	-	8 Fortune Ventures Development Corp.	6/1/98	
					9 Philippine Airlines, Inc.	6/19/98	
					10 Helbrock Ventures and Development Corp.	-	
					11 Globaland Constructors and Developers Corporation	7/2/98	
					12 Jentan Construction and Dev't. Corp.	7/29/98	
					13 Desert Fox Transport Corporation	8/3/98	
					14 Quarter Fashion and Garments Corp.	6/17/98	
					15 Gold-Richwell Development Corporation	8/26/98	
					16 Long River Developers Corp.	8/27/98	
					17 Plast-Print Industries, Inc. and CDC-Basic Packaging Industries, Inc.	10/5/98	
					18 Polymate Industrial Manufacturing Corp., Holland Industries, Inc., Holland Realty Development Corp.	10/5/98	
					19 Chung Fu Industries (Phils.), Inc.	11/24/98	
					20 Solar Steel Corporation	11/24/98	
					21 Sundowner Development and Corporation	12/21/98	
					and Centrepoint Hotel, Inc.		
<b>Total</b>	<b>5</b>		<b>10</b>		<b>21</b>		<b>36</b>

Year Filed	Withdrawn	Duration of the Case	Dismissed	Duration of the Case	On-going	Started	Total
1999		1 SM Sinop Company		22-day	1 Catmon Sales International Corporation	2/8/99	
					2 Trans-Philippines Investment Corporation	2/8/99	
					3 Stanford Resources and Development Corp.	3/3/99	
					4 Highlander, Inc.	4/28/99	
					5 Marfel Marketing Corporation	6/1/99	
					6 Sagay Diversified Industries, Inc.	6/17/99	
					7 Uniwide Sales, Inc., Uniwide Holdings, Inc., Naic Resources and Dect. Corporation, Uniwide Sales Realty and Resources		
					8 First Paragon Corporation		
					9 Uniwide Sales Warehouse Club, Inc.		
					8 Mt. Matutum Medical Center, Inc.	7/13/99	
					9 G.G. Sportswear Manufacturing Corp.,	7/26/99	
					Magic Apparel Corporation		
					10 Seashine Shipping and Trading Co., Inc	9/9/99	
<b>Total</b>	<b>0</b>		<b>1</b>		<b>10</b>		
<b>Grand Total</b>	<b>7</b>		<b>22</b>		<b>37</b>		<b>66</b>

Source: Securities and Exchange Commission

#### IV. MAJOR CHALLENGES AHEAD

Although the Philippine government and multilateral institutions have differed in their forecasts for the economy in 1999 and 2000, still they have agreed that the Philippine economy is well on the path to recovery (see **Table 10**). Yet, there is no room for complacency as the recovery is still taking its roots. Also, the 3 percent GDP growth rate projected for the Philippines for 1999 is much lower than those of crisis-hit countries, except Malaysia and Indonesia.<sup>13</sup> Thus, the authorities must now shift its priority from resuscitating the economy to sustaining the incipient economic recovery and accelerating further the economic growth in the coming years. This, of course, is a daunting task to do as the authorities face more challenges ahead. These are discussed in detail below.

<sup>13</sup> The latest GDP forecasts by ADB for Taipei (China), South Korea, Malaysia, Thailand, Singapore and Indonesia are 5-6%, 9%, 2%, 4-5%, 5-6% and 1-2%, respectively.

TABLE 10. FORECASTS ON SELECTED ECONOMIC INDICATORS						
	1 9 9 9			2 0 0 0		
	Philippine Government	ADB	IMF	Philippine Government	ADB	IMF
<b>GDP</b>	2.6 - 3.2	3.0	2.2	4.8 - 5.4	4.5	3.5
<b>GNP</b>	3.0 - 3.7	3.3 - 3.8%		5.3 - 5.9	5.0 - 5.5%	
<b>Inflation rate</b>	8.0 - 9.0	7.5	8.5	6.5 - 7.5	7.0	6.0

Sources:

*Medium-Term Philippine Development Plan 1999-2004 Executive Summary*

*Asian Development Outlook 1999 Update, Asian Development Bank*

*The World Economic Outlook Database September 1999, International Monetary Fund*

The balance sheets of Philippine commercial banks and corporations have not been as badly impaired as those of neighboring crisis-hit countries. The Philippines, therefore, is in a better position to sustain the recovery in that it would not cost much for the country to clean up and repair those balance sheets. Also, there is no need for the government to step in to bail out failing banks and corporations or to transform private debt to public debt to get the economy going as it did in the mid-1980s. Any financial or corporate restructuring can very well be handled by the private sector. Thus, constraints from growth would not come from inability of banks to function as financial intermediaries nor from the need to do a massive clean up first of the balance sheets of corporations, as other crisis-hit Asian countries have to deal with.<sup>14</sup> A recent study found no evidence that would support the existence of a credit crunch in the Philippines in the wake of the Asian financial crisis (Lamberte 1999).<sup>15</sup> The slowdown in bank loans was mainly due to the depressed demand for loans by enterprises that have been scaling down their operations because of the reduced demand for their goods and services. The acceleration in the growth rate of GDP, therefore, must come from the demand side.

The expansionary fiscal stance has played a big role in the recent economic recovery. Also, the decision of the government to finance its deficit by borrowing

<sup>14</sup> In fact, both the peso and dollar-denominated deposits in commercial banks have continued to grow, albeit at a lower rate, during the crisis period.

<sup>15</sup> Again, this distinguishes the Philippines from other crisis-hit countries which were found by several studies to have been experiencing a credit crunch since the onset of the Asian financial crisis.

abroad has reduced pressure on the domestic interest rate, which has provided a wholesome environment for private-sector initiated loan work-outs for some troubled corporations. However, this fiscal expansionary stance cannot anymore be relied upon to further prop up the economic recovery in the near term. Because of its below-target tax collection, the budget deficit already reached P98.8 billion (US\$2.4 billion) as of October 1999, well above the original target of P68.2 billion for the entire year.

The Philippines' government revenue collection is one of the lowest in the region. It stood at 16.6 percent of GNP in 1998, down from 18.7 percent in 1997. Unless revenue collection can be increased dramatically in the near term, then prudence dictates that the government must scale down its expenditures next year to trim down the deficit. Otherwise, the ballooning budget deficit can go out of hand and cause macroeconomic instability in the coming years. This issue is doubly important because currently a large portion of the government's outstanding debt is denominated in foreign currency. Fiscal policy, therefore, must now give utmost priority to maintaining stability of the economy to pave the way for other sectors of the economy to take the lead in the recovery. The government must also pay greater attention to the management of its external debt.

Private consumption is expected to inch up in the coming years. Part of the demand will be coming from the rural, agricultural sector, which is recovering from the effects of the El Nino weather phenomenon in 1998. However, a portion farmers' income will be used to clean up their arrearages incurred in 1998. Part of the increased demand will be coming from urban households who have postponed buying consumer durables in the wake of the financial crisis. The prevailing low inflation and low interest rates provide an environment conducive for private consumption growth. This must be complemented by a good competition policy so that consumers can have a wider array of choices of goods and services at competitive prices. The proposed liberalization of the retail trade sector can certainly help in this regard.

The export sector will play a key role in sustaining the recovery. The expected rapid economic recovery of crisis-hit countries, especially Singapore, Taiwan and Hong Kong, will definitely provide additional spark to the export sector.

There are three major issues that must be addressed here. The first relates to the need for avoiding the overvaluation of the peso to support the competitiveness of Philippine exports. The current policy of the Bangko Sentral to let the peso seek its own level must, therefore, be maintained. The second issue is the need for diversifying the country's exported products. While the share of manufactured goods in the total exports rose from 70 percent in 1990 to 90 percent in 1999, however, about 60 percent of it came from semi-conductor products and another 14 percent from machinery and transport equipment (see **Table 11**). This makes the Philippines' exports highly vulnerable to sudden shifts in the demand for these products, not to mention the fact that these products have low value-added.<sup>16</sup> To minimize this risk, the Philippines must exploit its potentials for diversifying its exported products especially those that have high value-added without necessarily de-emphasizing the two exported products mentioned above. Data show that it has comparative advantage on a number of products, such as: fish and preparations; fruit and vegetables; metalferrous ores (scrap); crude animal vegetable materials; fixed vegetable oil (fat); processed animal vegetable oil; fertilizers manufactured; wood, cork manufactures; furniture; travel goods handbags; clothing; and footwear.<sup>17</sup> Active promotion of these products is in order. The third issue is the need for greater market diversification by increasing its penetration to the European market. Many of the exporters have yet to be initiated to the vast European market. In this regard, the government has to work closely with private sector associations, such as Philexport, to increase the level of awareness of exporters to the European market.

Increasing the investment component of aggregate demand is perhaps the biggest challenge the Philippines faces in sustaining the economic recovery and propelling the economy to a higher growth path. **Table 12** shows the extent of capacity underutilization of key enterprises as a result of the downturn of the economy. The proportion of firms with capacity utilization of less than 50 percent rose from 10 percent before the regional crisis struck to 28 percent as of the third quarter of 1999. This is expected to improve as the economy recovers. Certainly, the low interest rate policy during the recovery period would be a very important policy

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<sup>16</sup> The good news is that the large exports of semi-conductors have recently encouraged the entry of input-supplying firms.

<sup>17</sup> This is based on the computed revealed comparative advantage using the NAPES database.

YEAR	1990		1991		1992		1993		1994		1995		1996		1997		1998		Jan-Jul 1999	
	Share	Share																		
Total Exports <sup>1/</sup>	8186	100	8840	100	9824	100	11375	100	13483	100	17447	100	20543	100	25228	100	29496	100	18654	100
Primary Commodities	2366	29	2338	26	2396	24	2443	21	2613	19	3198	18	2949	14	2965	12	2586	9	1247	7
Manufactures	5706	70	6403	72	7293	74	8729	77	10615	79	13868	79	17095	83	21462	85	25866	88	16563	89
A. Top 7 Manufactures																				
1. Elec & Elec Eqpt/Parts & Te	1964	24	2293	26	2753	28	3551	31	4984	37	7413	42	9990	49	13052	52	17156	58	11108	60
2. Machinery & Transport Eqpt	150	2	181	2	288	3	363	3	469	3	741	4	1296	6	2686	11	3318	11	2567	14
3. Garments	1776	22	1861	21	2140	22	2272	20	2375	18	2570	15	2423	12	2349	9	2356	8	1269	7
4. Chemicals	261	3	304	3	268	3	262	2	306	2	343	2	353	2	383	2	339	1	174	1
5. Furniture & Fixtures	189	2	177	2	181	2	203	2	240	2	276	2	293	1	322	1	324	1	192	1
6. Textile Yarns/Fabrics	93	1	100	1	121	1	118	1	173	1	208	1	253	1	299	1	242	1	125	1
7. Processed Food & Bev	207	3	233	3	220	2	271	2	303	2	292	2	334	2	346	1	306	1	147	1
	4640	57	5149	58	5971	61	7040	62	8850	66	11843	68	14942	73	19437	77	24041	82	15582	84
B. Other Manufactures	1066	13	1254	14	1322	13	1689	15	1765	13	2025	12	2153	10	2025	8	1825	6	981	5
Others	114	1	99	1	135	1	203	2	255	2	381	2	499	2	801	3	1044	4	844	5

<sup>1</sup> Details may not add up to total due to rounding.  
Source: National Statistics Office

to pursue so that firms can access credit from banks at a low cost to supplement internally generated funds to finance the build-up of inventories.

CAPACITY UTILIZATION	1997				1998				1999		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Below 50%	9.3	10.5	10.0	11.2	10.4	13.1	11.8	12.5	14.3	22.5	28.3
50-59%	9.7	8.7	9.3	10.4	11.6	9.9	11.4	12.5	10.6	9.0	8.0
60-69%	15.0	14.9	13.4	13.5	17.1	14.1	16.8	15.9	14.3	13.3	12.4
70-79%	21.7	23.1	22.2	21.6	21.6	21.3	22.3	20.3	22.1	19.0	20.1
80-89%	26.1	25.9	25.8	24.0	22.0	23.9	20.9	23.5	22.6	21.0	17.1
90-100%	18.1	16.9	19.1	19.3	17.5	17.7	16.8	15.4	16.0	15.3	14.1

Source: National Statistics Office

But some of these firms have to bow out for failure to respond to the structural reforms initiated by the government earlier or for being poorly managed.<sup>18</sup> This is where a good bankruptcy law, complemented by a good accounting system to limit the error in valuing assets, counts a lot so that assets of distressed enterprises can immediately be transferred at a minimal cost to those who can make use of them more

<sup>18</sup> Examples are the National Steel Corporation, which the government retains a minority stake after it was privatized a few years ago, and the Victorias Milling Corp.

productively.<sup>19</sup> This will certainly attract a new wave of FDI based on mergers and acquisition.<sup>20</sup>

There are two existing laws governing distressed company. One is Republic Act 1956 or the Insolvency Law of 1909. The country's insolvency law has a direct bearing on the ability of banks and other creditors to recover debt. They may end up with unsecured claims for deficiencies after foreclosing on their security because of certain provisions of the insolvency law. It seeks to distribute equitably the property of debtors in financial distress and to free debtors from the burden of indebtedness. This law lists 14 categories of preferences that must be satisfied before the rule of pro rata distribution is implemented. The preferred claims and their order of priority are as follows:

- (1) funeral expenses for the debtor or the children without property;
- (2) claims for services by debtor's employees, laborers or helpers;
- (3) expenses during the last illness of the debtor or spouse or children without property;
- (4) workmen's compensation of laborers or their dependents;
- (5) advances for support of debtor and his family for the year preceding insolvency;
- (6) support during insolvency proceedings and 3 months thereafter;
- (7) fines and civil indemnification arising from a criminal offense;
- (8) legal and other expenses arising from the administration of the insolvent debtor's estate;
- (9) national taxes and assessments other than property taxes, which are a firstcharge payable out of the proceeds of such property in priority even to debts secured by a mortgage or pledge of the property;
- (10) provincial taxes and assessments;
- (11) city or municipal taxes;
- (12) damages for death or personal injury;

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<sup>19</sup> Some distressed corporations were later found out to have hidden liabilities which were never detected by their external auditors. A case in point is the cellular phone company PILTEL, a subsidiary of PLDT, which was recently taken over by foreign investors.

<sup>20</sup> Indeed, some of the recent FDI were used for merger and acquisition. A case in point is the entry of foreign cement corporations acquiring local cement factories.

- (13) gifts due to public and charitable institutions; and
- (14) claims evidenced by (i) a public instrument or (ii) judgment resulting from litigation.

While there are worthy reasons for the listed categories, this particular rule of law seems burdensome to creditors of insolvent debtors. The policy issue here is to limit the number of preferences and/or provide a ceiling on the amounts that can be claimed by certain categories. For example, the 13th preference can be abused by bestowing gifts or donations in utter disregard of the loans that must be paid by the debtor.

In the Philippines, the process of judicial and extrajudicial foreclosures takes a long time and this is not very reassuring to creditors who would expect prompt settlement of debts. Delays negate the potential of judicial and extrajudicial foreclosure as remedies that can be easily availed of by creditors in the face of loan defaults. Because of the delays and the uncertainty created by the long litigation process, banks will not be encouraged to provide secured long-term credits. On the other hand, redemption period together with the process of redemption and the differential treatment of bank and nonbank mortgagees in judicial foreclosure deserve a careful review because they can be a source of delays in debt recovery.

The other law is Presidential Decree 902-A, which took effect in 1976. It addresses the issue of suspension of payments in cases where the distressed company seeks approval of a rehabilitation plan. It gives the SEC the exclusive and original jurisdiction over corporate petitions for suspension of payments to their creditors. The SEC gives the final approval of a rehabilitation plan for a distressed company approved by a management committee, which it appoints. The management committee is composed of representatives from the distressed company, creditors and the general public. A rehabilitation plan of a distressed corporation could include debt restructuring, condonation of certain interest charges and penalties, and conversion of debt to equity, among others. One of the controversial aspects of this law was the Supreme Court's ruling putting secured creditors on equal footing with unsecured creditors whenever a distressed company asks SEC for a rehabilitation and

suspension of payments. Thus, foreclosure is not allowed until the SEC decides to liquidate a distressed company.

While PD 902-A sets out an orderly process of rehabilitating or liquidating distressed corporations, it raises some issues on corporate governance. One is the moral hazard problem. Corporations can be more aggressive in borrowing funds from creditors knowing that they can resort to suspension of payment in the event they get into financial difficulties. Unsecured creditors can be more aggressive in lending to a corporation knowing that they will be placed on equal footing with secured creditors in the event said corporation becomes in distress and seeks approval from SEC of a rehabilitation plan. This could lead to highly leveraged corporations.

The other issue is that it slows down the exit of truly insolvent companies because it confers some incentives to owners going for a rehabilitation route rather than for an immediate liquidation. Smooth entry and exit of firms is an essential element in a competitive market economy. Assets of insolvent companies should immediately be disposed of so that they can be used by others who can utilize them optimally. The continuous corporate restructuring will make the economy as a whole efficient.

Still another issue is that it gives a government agency, i.e., the SEC, the power to decide, albeit with the help of the management committee, to decide which companies should be rehabilitated or liquidated. It has a direct bearing on the capacity of the SEC to quickly resolve petitions for rehabilitation of distressed corporations. As already mentioned earlier, the record of SEC in this regard is not encouraging. This is definitely a poor substitute to a market solution.

To date, there is no successful SEC-supervised rehabilitation case since the effectivity of the law. Saldana (October 1999) recommended that the country revert to the old law requiring that two-thirds majority of creditors accept any rehabilitation plan of troubled debtors with SEC playing the role of an arbiter in troubled debt restructuring. Other proposals put forward by Saldana to improve corporate governance in the country must be seriously considered and pursued by the government.

To move to a higher growth path in the coming years, the Philippines must raise further its investment rate. This is a tall order considering the fact that the Philippines' annual saving rate has historically been far below its investment rate and has been the second lowest in the ASEAN region in the last two years (see **Table 13**). The challenge the government is facing here is how to mobilize more domestic savings for long-term investment and to attract foreign direct investment to supplement the domestic savings. As regards mobilization of domestic savings, the efforts currently exerted by the government to reform the capital market and amend the general banking act are steps in the right direction.<sup>21</sup> The proposed new Securities Act is designed to improve corporate governance, which is a vital factor for attracting both local and foreign funds to the capital market. Both local and foreign minority shareholders definitely need transparency of listed firms' operations and adequate protection from unfair treatment of majority shareholders. To strengthen further the capital market, the above-mentioned reform must be complemented by reform in the contractual savings system, which has the potential for generating more long-term funds.<sup>22</sup> The private contractual savings institutions need to be well regulated and closely supervised by a strong supervisory body to ensure their safety and

<b>TABLE 13. GROSS DOMESTIC SAVINGS</b>									
<b>As % of GDP</b>									
<b>Annual Data: 1994 - 2000</b>									
<b>Country</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<i>a/</i>	<b>2000</b>	<i>b/</i>
Singapore	48.8	50.9	51.2	51.8	52.2	50.0		49.0	
Malaysia	38.8	39.5	42.6	43.8	48.0	47.1		46.1	
Thailand	34.7	33.6	33.7	32.9	35.9	33.2		33.0	
Indonesia	29.1	28.5	27.3	29.9	19.1	18.5		19.0	
Philippines	17.0	16.8	18.5	20.3	20.0	20.2		20.3	

*a/ target*

*b/ forecast*

Source: *Asian Development Outlook, 1999*

<sup>21</sup> The proposed new securities act and the new general banking act are expected to be passed by Congress towards the end of 1999 or early 2000.

<sup>22</sup> This includes the mandatory and the voluntary contractual savings schemes, such as life insurance, pre-need plans, mutual funds and occupational pension plans.

soundness.<sup>23</sup> Aside from mobilizing long-term funds, contractual savings institution as institutional investors in major enterprises in the country can help improve corporate governance.

The Philippines has lagged far behind other ASEAN countries in terms of attracting foreign direct investments despite its much improved investment policy and having a large pool of highly educated and English-speaking labor force. As **Table 14** shows, its share in the total FDI to ASEAN averaged only 5.8 percent during the period 1992-97. As a percent of GDP, FDI averaged only 1.3 percent for the same period. To enhance its competitiveness in attracting FDI, the government must pay greater attention to improving infrastructure and support services<sup>24</sup> to bring down the cost of doing business in the country and liberalize further some sectors of the economy to widen the investment opportunities for foreign investors. While it continues to secure ODAs to finance some of its large infrastructure programs, the government must promote greater private sector participation in infrastructure programs through a fairer and more transparent application of the BOT law.<sup>25</sup> The utilities sector must be liberalized to attract more players including foreign investors into the sector to improve the sector's efficiency. The passage of three important bills, namely the power sector bill aimed at deregulating the power sector, the retail trade bill that proposes to open up the retail trade sector to foreign investment and the bill that seeks to amend the general banking act to allow foreign banks to have greater participation in retail banking, will not only help in attracting FDI to the country but will also introduce more competition into these sectors.

The government must take a closer look at why intermediate industries are absent in the Philippines (Ravallo 1999). Like the rest of East Asian economies, the Philippines has relatively been successful in shepherding foreign investment to

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<sup>23</sup> In particular, there is no regulatory framework for pre-need plans and occupational plans. The collapse of one of the pre-need plan companies recently has raised concerns about the strength of the entire pre-need plan industry.

<sup>24</sup> This includes one-stop facilitation of administrative approvals, support for labor procurement and skills development, matchmaking between foreign investors and local suppliers, among others.

<sup>25</sup> The legal problems encountered by some BOT projects that have substantial foreign equity participation do not inspire potential local and foreign investors in investing in infrastructure projects. Also, the rules on unsolicited BOT proposals need to be firmed up.

<b>TABLE 14. FOREIGN DIRECT INVESTMENTS TO ASEAN</b>							
<b>Annual Data: 1992 - 1997</b>							
<b>Percent Share</b>							
<b>Country</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>Average 1992 - 97</b>
Singapore	19	31	47	40	39	41	36.2
Malaysia	45	33	24	20	19	15	26.0
Thailand	18	12	7	9	9	15	22.7
Indonesia	15	13	11	21	25	22	17.8
Philippines	1	8	8	7	6	5	5.8
<b>Total (%)</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	
<b>\$ million</b>	<b>11,506</b>	<b>14,738</b>	<b>17,732</b>	<b>20,151</b>	<b>24,094</b>	<b>23,957</b>	

Source: Asian Development Outlook, 1999

export-oriented enterprises, but these may have very little linkages with the rest of the domestic economy. There might be some scope for finetuning investment policies so that they do not only generate new green-field FDI but also encourage multinational corporations to deepen their local operations and/or strengthen the formation of local linkages. The breaking down of tariff walls within the ASEAN region, for example, has already prompted some multinational companies to consolidate their operations in one country. This is important as the Philippine economy deepens its integration into the global economy.

Finally, the government must anticipate the needs of new entrants into the domestic economy. The new entrants are likely to be global players demanding not only the highest quality of infrastructure and support services from host countries but also highly skilled labor particularly with engineering knowledge and talent. Although short-term training can address it in the short-run, in the long-run, however, the educational system of the country has to respond to it to exploit the opportunities that it offers.

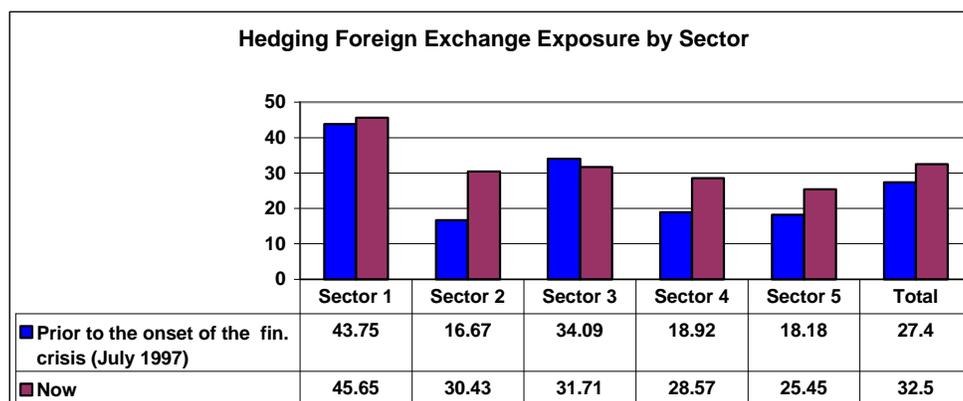
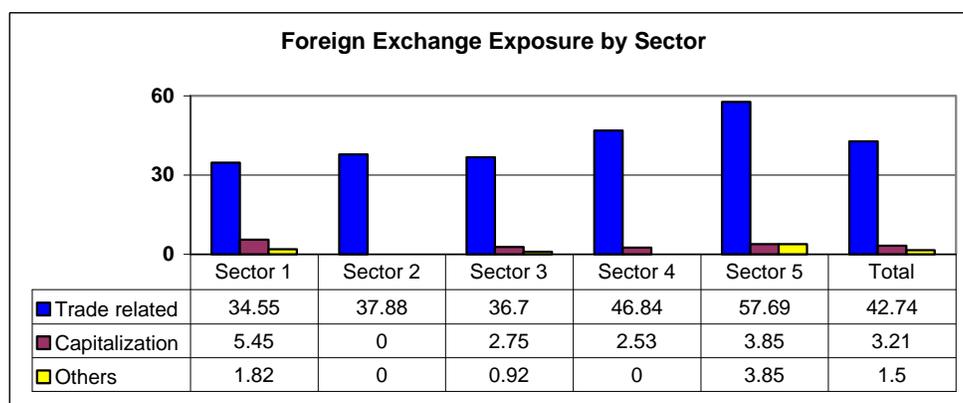
## V. CONCLUDING REMARKS

The Philippines was not as badly affected by the regional financial crisis as other Asian countries for at least three reasons: it had undertaken substantial structural reforms in the 1990s to strengthen key sectors of the economy; it was a latecomer to the massive capital inflows into the region; and its banking and corporate sectors came into the crisis with relatively strong balance sheets. The challenge facing the country is not only to stage a quick recovery, which the economy seems to be currently experiencing, but also to propel the economy to a higher growth path in a sustainable manner. To achieve this objective, the Philippines has to perform two major tasks, which are not altogether new.

One is to ensure macroeconomic stability. In this regard, the government must pay particular attention to containing its budget deficit and managing well its foreign and domestic debt. It must also pursue a consistent exchange rate policy to prevent the recurrence of the condition that prevailed before the crisis and reduce the country's risk to sudden shift in short-term capital flows. Flexible exchange rate can manage that risk. The credibility of the authorities not to defend the domestic currency from major attacks can greatly reduce the incentives for speculators to play in the foreign exchange market. Enterprises that are exposed to exchange risk should learn how to use some hedging instruments to cover themselves against adverse exchange rate movements. This needs to be emphasized especially since data show that only a few of those that had foreign exchange exposure made extra effort in availing themselves of hedging instruments before and after the Asian financial crisis (see **Figure 4**).

The other is to continue the structural reforms so that the country can exploit the opportunities created by the globalization of trade and finance. Interestingly, some of the blueprints for deepening and broadening the structural reforms were already formulated before the Asian financial crisis. For instance, bills were already filed in Congress long before the Asian financial crisis struck to modernize the financial system, raise prudential standards and improve the regulatory environment so that it can develop in step with the growth of the rest of the economy.

**FIGURE 4. SELECTED DATA ON FOREIGN EXCHANGE EXPOSURE**



**SECTOR**

1- Food

2- Textiles

3- Wearing apparel

4- Chemicals

5- Electrical machinery

Source: Survey of Philippine Industry and the Financial Crisis, 1998

The recent crisis and the lessons derived therefrom have certainly made the implementation of these structural reforms more urgent than ever. The crisis has also inspired reforms in some areas, such as the need to revise the bankruptcy law to deter corporate owners and managers from misusing corporate and borrowed funds and ensure the smooth transfer of assets. This can pave the way for another wave of FDI based on merger and acquisition, which, aside from bringing in more foreign capital, can also raise the efficiency of domestic enterprises and eventually turn them into regional or global players.

The structural reforms envisioned in the coming years should address the need for the country to develop intermediate industries to support the industrialization process and to deepen the local operations of foreign-owned enterprises as well as strengthen their linkages with local firms.

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