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Investment Policy for Transition to a Market Economy: The Philippine Case

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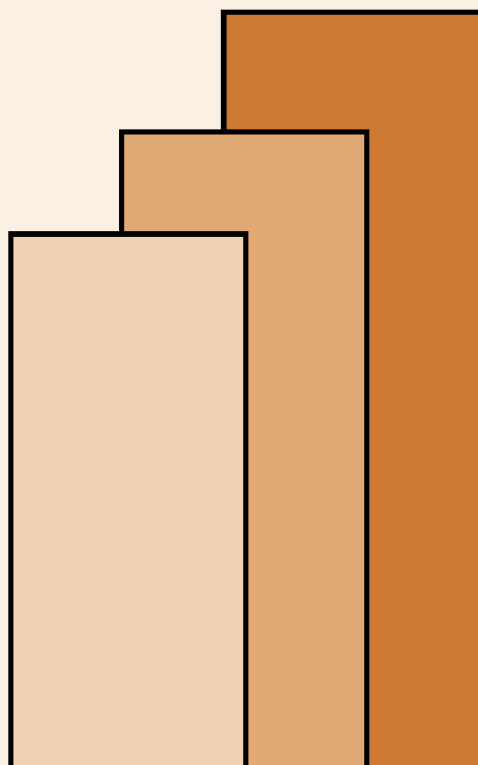
Mario B. Lamberte

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**INVESTMENT POLICY FOR TRANSITION
TO A MARKET ECONOMY:
THE PHILIPPINE CASE***

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Vice-President
Philippine Institute for Development Studies**

***Paper presented during the Workshop, "Investment Policy for Transition to a Market Economy,"
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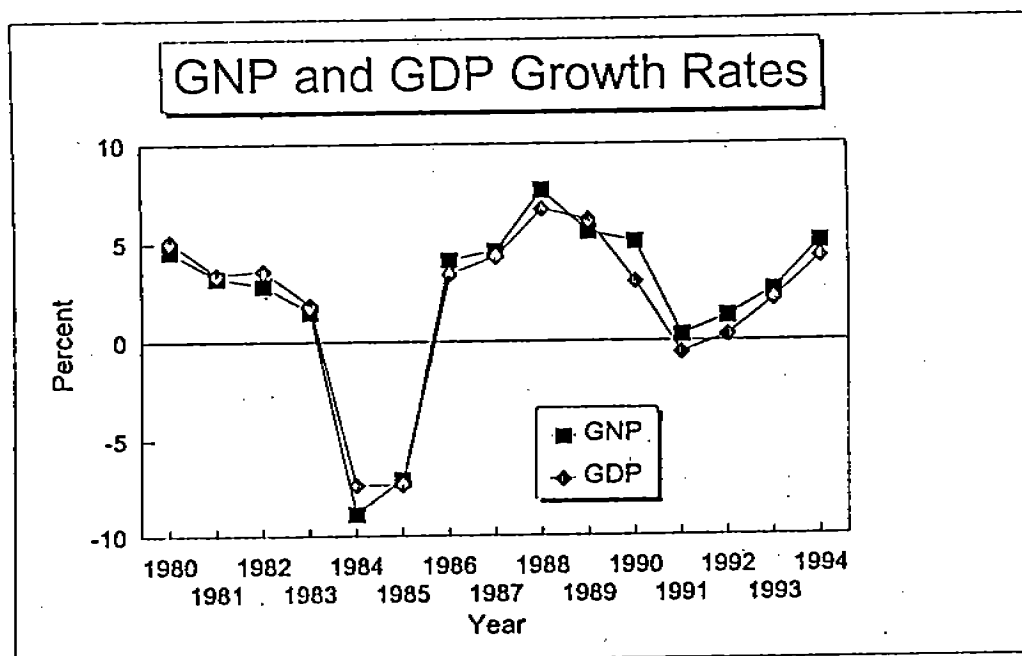
INTRODUCTION

The Philippines earnestly began to liberalize its economy in the early 1980s with the implementation of the first phase of the tariff reform program and the restructuring of the financial system. The economy, however, has been generally unstable during the period 1980-1994 (Table 1). In particular, growth consistently declined in the early 1980s. By mid-1980s, the economy went into a two-year recession. The economy strongly recovered after 1985, but the recovery was not sustained. After peaking in 1988, growth again started to decelerate and reached its lowest point in 1991. The economy recovered mildly in 1992 and 1993 and posted a robust growth in 1995. The GNP growth rate of 5.1 percent achieved in 1994 is a strong indication that the Philippine economy is now well on its way to a sustained growth. This year, the economy is expected to grow by 6 percent.

The investment rate of the country plunged precipitously during the 1984-85 economic crisis and gradually recovered thereafter (Table 2). However, the investment rate in 1994 has not yet reached the levels attained before the 1984-85 crisis. The saving rate followed the same trend as that of the investment rate up until 1988. Starting in 1989, the saving rate declined continuously, a trend that was reversed only in 1994. During this period, the saving-investment gap generally worsened,

Table 1
Performance of the Philippine
Economy, 1980-1994
(In Percent)

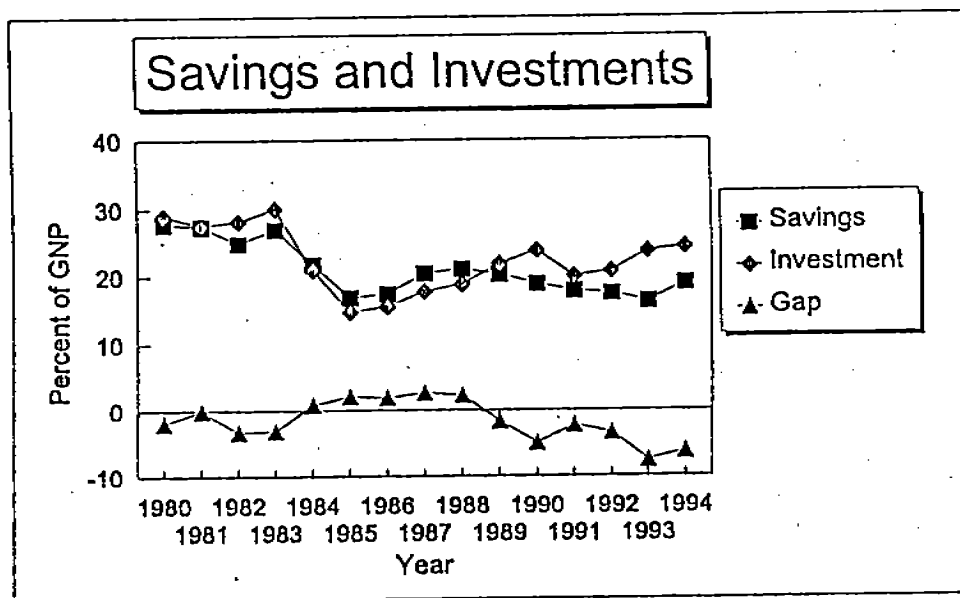
Year	GNP	GDP
1980	4.63	5.15
1981	3.24	3.42
1982	2.84	3.62
1983	1.51	1.87
1984	-8.83	-7.32
1985	-7.02	-7.31
1986	4.15	3.42
1987	4.62	4.31
1988	7.71	6.75
1989	5.61	6.21
1990	5.10	3.04
1991	0.34	-0.58
1992	1.27	0.34
1993	2.60	2.10
1994	5.08	4.28



Source: *Economic and Social Statistics Office*
National Statistical Coordination Board

Table 2
Savings and Investment
 '(As Percent of GNP)

Year	Savings	Investment	Gap
1980	27.76	29.04	-1.88
1981	27.47	27.57	-0.09
1982	24.96	28.2	-3.23
1983	27.02	30.07	-3.05
1984	21.84	20.99	0.85
1985	16.89	14.75	2.14
1986	17.47	15.56	1.91
1987	20.48	17.81	2.67
1988	21.12	18.84	2.28
1989	20.3	21.87	-1.57
1990	18.93	23.83	-4.9
1991	17.87	20.06	-2.19
1992	17.49	20.81	-3.33
1993	16.28	23.78	-7.5
1994	19.03	24.35	-6.14



Source: National Income Accounts
 National Statistical Coordination Board

which, if it continues, will eventually pose a serious threat to the sustainability of the recent economic growth.

PRIORITIES FOR PUBLIC INVESTMENT PROGRAMS¹

Each Administration draws up a Medium-Term Philippine Investment Plan (MTPIP), which serves as the basis for formulating the annual capital outlay budget of the National Government and financial plans of major government corporations. The MTPIP is developed using a "bottom-up" approach, in which all government departments, offices and instrumentalities including local government units formulate their respective medium-term plans and public investment programs following the planning and programming guidelines provided by the President. Under the Ramos Administration, the public investments programs are to be guided by the following specific plan objectives: (a) poverty alleviation; (b) reduction of inequality; (c) generation of productive employment opportunities; (d) comprehensive human development; and (e) attainment of sustainable growth.

The MTPIP resources for 1994-1998 were estimated at P693.02 billion to be distributed as follows:²

Infrastructure Development	71%
Agri-Industrial Development	13%
Human Development	12%
Development Administration	2%
Disaster Mitigation	2%

About 40% of the total resources will be obtained from external sources.

¹This is based on the "Medium-Term Public Investment Program, 1993-1998."

²The present exchange rate is approximately P26.00 per US\$1.

In the infrastructure sector, new generating plants with the necessary transmission lines will be constructed to increase generating capacity by 3,866 MW during the Plan period; 12,200 kms. of national roads will be rehabilitated/improved; 358,775 hectares will be irrigated and 416,491 hectares will be rehabilitated for national and communal systems; 9,498 classrooms for elementary schoolbuildings will be built; and 80,240 main telephone stations will be installed nationwide. To have a better focus on its infrastructure program, the government established in 1994 the so-called Core Public Investment Program (CPIP), a set of priority projects whose implementation will not be delayed even when there are budgetary shortfalls. The CPIP included 85 flagship projects worth P220 billion. Fifty of the 85 projects worth about P100 billion were already started in 1994. So far, 3 projects worth P7.7 billion were completed in 1994 and 5 projects worth P3.4 billion will be completed this year. For the agriculture sector, major programs and projects would be focused on the identified priority commodities namely rice, corn, coconut, sugar, cotton, fiber, cutflowers, fruits, and vegetables, swine and poultry, cattle, carabao and dairy. On environment and natural resources, 104,000 hectares of industrial forestry plantations will be established and 305,000 hectares will be planted through contract reforestation. For the industry, a regional industrial center (RIC) will be established for each of the 14 regions of the country. The education sector will provide instructional facilities, materials and equipment for its various programs including nonformal education programs. For the housing sector, resettlement sites for squatter families will be developed. For the health sector, the Medicare Program will be expanded and various public health and disease control programs will be implemented. For disaster mitigation, flood control/drainage work/dredging and the appropriate public works for disaster stricken areas will be undertaken.

MEASURES TO PROMOTE PRIVATE INVESTMENT

The government introduced major reforms in almost all areas of the economy during the period 1986-1994 to improve the general economic environment, thereby encouraging more private sector investments; to change the structure of the economy towards a more efficient and internationally competitive one; and to build a firmer foundation for a sustained growth.

In the *trade sector*, the Philippines undertook several unilateral trade liberalization efforts. Between 1986 and 1993, the number of regulated items was reduced from 1,924 items to 183. In 1991, the government embarked on a five-year tariff reduction. By 1995, the Philippines will have a nine-band tariff structure, with items concentrated at 3, 10, 20 and 50 percent tariffs. In 1994, the government implemented the following additional tariff reform measures: (1) adoption of a minimum tariff of 3 percent on items not covered by earlier trade liberalization program; (2) reduction to 3-10 percent tariff on capital equipment and spare parts; and (3) reduction in the rates of duty on garments, textiles and raw materials thereof. The Senate also ratified the Philippine commitments under the GATT-UR.

The trade reforms initiated in the 1980s already produced some desirable results. In particular, there had been a significant industry deconcentration, with relatively small-scale plants comprising a large majority of new entrants into industries that effectively reduced the large-scale bias of Philippine manufacturing industries encouraged by the previous policy regime (Medalla et al. forthcoming). Accordingly, this occurred without loss of efficiency.

In the *fiscal sector*, tax reforms were initiated in the second half of the 1980s to improve the elasticity of the tax system, promote equity by ensuring that similarly situated individuals and firms bear the same tax burden, promote growth by withdrawing or modifying taxes that impair incentives

to produce, improve tax administration by simplifying the tax system, and promote tax compliance. One significant tax reform was the adoption of the Value Added Tax (VAT) that replaced several sales taxes. Both local and foreign investors whose enterprises are included in the Industrial Priority Plan may register with the Board of Investment (BOI) and avail themselves of fiscal incentives which include:³ income tax holiday; additional deductions for labor expense; tax and duty exemptions on imported capital equipment; tax credit on domestic capital equipment; tax credit for taxes and duties on raw materials; access to bonded manufacturing/training warehouse system; and exemption from wharfage dues and any export tax, duty and fee. Table 3 shows the number of projects and total project cost registered with the BOI.

To increase further the role of the private sector in the domestic economy and encourage more private sector investment, the government initiated in 1986 a privatization program. As of December 1993, 327 out of 419 assets transferred by government financial institutions to the Asset Privatization Trust (APT)⁴ and 81 out of 130 government-owned or controlled corporations targeted for disposition were already sold or liquidated, generating a total of P77.8 billion in revenues for the government. In 1994, the government successfully privatized two large government-owned corporations in the petroleum and steel industries.

The government expects the private sector to finance 63 percent of the total cost of the CPIP which was mentioned above. To facilitate the participation of the private sector in infrastructure projects, the government amended the Build-Operate-Transfer (BOT) law to widen the coverage of authorized contractual arrangements (Table 4). Aside from the widened contractual arrangements,

³This is provided for under Executive Order No. 226, otherwise known as the Omnibus Investment Act of 1987.

⁴APT was created in 1986.

Table 3
Summary of Selected Statistics on Projects
Approved Under E.O. 226
January-December, 1990-1994
(In Thousand Pesos)

	1990	1991	1992	1993	1994
Total Number of Projects	3,108	2,115	2,248	510	813
Project Cost	107,282,869	83,376,718	99,101,156	92,498,510	454,850,685
Equity	48,937,984	43,560,752	27,752,729	33,940,368	159,545,849
Local	27,960,728	22,171,403	20,502,343	19,525,790	97,780,681
Foreign	28,977,256	21,389,349	7,250,386	14,414,578	61,765,168

Source: Board of Investments
Filename: TAB5BOI#

Table 4
Different BOT Schemes

Build-Own-and-Operate	<ul style="list-style-type: none"> o Private sector finances, constructs, owns, operates and maintains facility.
Build-Lease-and-Transfer	<ul style="list-style-type: none"> o Private sector finances and constructs facility. o Government leases facility for fixed period. o Government owns facility upon expiration of lease.
Build-Transfer-and-Operate	<ul style="list-style-type: none"> o Government finances project. o Contractor builds facility. o Contractor operates facility on behalf of Government agency.
Contract-Add-Operate	<ul style="list-style-type: none"> o Private sector leases existing government facility. o Private sector undertakes expansion/improvement. o Private sector operates the project.
Develop-Operate-and-Transfer	<ul style="list-style-type: none"> o Private sector undertakes project. o Project results in higher property values for adjoining property. o Private sector obtains right to develop property.
Rehabilitate-Operate-and-Transfer	<ul style="list-style-type: none"> o Private sector rehabilitates, operates, and maintains existing Government facility. o Government retains ownership upon expiration of contract.
Rehabilitate-Own-and-Operate	<ul style="list-style-type: none"> o Private sector rehabilitates existing government facility. o Private sector operates facility for indefinite period on the condition that it does not violate the terms of its franchise.

Source:

Philippines Private Sector Assessment (PSA), July 12, 1994
Volume II: Main Report

the amended BOT law also expanded the coverage of projects eligible as private sector infrastructure or development projects, which now include practically any infrastructure and non-infrastructure development projects that may be authorized by the appropriate agencies. Table 5 gives a list of priority BOT projects for the next five years where private sector participation is earnestly encouraged.

In the *financial markets*, more competition has been promoted by removing controls on interest rates, rationalizing the government credit programs so as not to compete with private financial institutions, privatizing several government-controlled banks, and liberalizing the entry of new domestic banks and bank branching. As a result, the number of bank offices increased by about one thousand between 1989 and 1993. A law was passed in mid-1994 liberalizing the entry and scope of operations of foreign banks. Under this law, up to 10 foreign banks will be allowed to open 6 branches each in the country. In addition, foreign banks will be allowed to acquire up to 60 percent ownership of domestic banks. On 14 February 1995, the Monetary Board announced the 10 foreign banks out of 22 applicants that will be allowed to establish branches with full banking authority in the country. The approval of the 10 banks brings to 14 the total number of foreign banks allowed to do full commercial banking operations in the country.

In the *foreign exchange market*, a substantial number of exchange controls, such as surrender requirement for export proceeds, prior Bangko Sentral ng Pilipinas (BSP) approval for export transactions and any payment on any forex transactions and capital repatriation/dividend/interest remittance privilege, have been removed in the last four years.⁵ Last

⁵BSP is the Philippines' central bank.

Table 5
Priority BOT Projects

	Project Cost (Millions of US\$)
<u>Road Projects</u>	
M. Manila Skyway	635.6
North Expressway, Subic/Clark	290.5
Manila-Cavite Expressway	79.1
S. Luzon Expressway Expansion	69.7
	<hr/> 1,074.9
<u>Transport Projects</u>	
Light Rail Transit No. 4	678.4
Light Rail Transit No. 5	279.8
Mainline North Rehabilitation	76.8
NAIA Cargo Terminal	84.8
Manila Grains Terminal	95.5
	<hr/> 1,215.3
<u>Power Projects</u>	
Small Hydro Program	425.4
Mindanao Geothermal	323.1
	<hr/> 748.5
<u>Water Supply Projects</u>	
Bulacan Central Water Supply	37.1
Cavite Water Supply	164.0
	<hr/> 201.1
<u>Tourism Projects</u>	
Panglao Island Tourism Estate	42.7
Samal Island Tourism Estate	44.7
	<hr/> 87.4
<u>Industrial Estate Projects</u>	
PHIVIDEC Expansion	6.6
Batangas City Agro-Industrial Center	83.5
Bacnotan Agro-Industrial Center	50.4
Pavia Agro-Industrial Center	30.2
Davao City Agro-Industrial Center	24.2
Zamboanga Agro-Industrial Center	12.2
	<hr/> 207.1
TOTAL	<hr/> <hr/> 3,534.3

Source:

Philippines Private Sector Assessment (PSA), July 12, 1994
Volume II: Main Report

year, the restriction on the repatriation of investments and earnings on foreign investments under the debt-to-equity conversion program was lifted; the allowable annual outward investments that an investor can source from the banking system was increased from US\$1 million to US\$6 million; the foreign exchange forward cover of the oil industry was phased out in stages starting December 1, 1994 from 180 days to 120 days, and further reduction by 30 days after each subsequent quarter; and restrictions on automatic conversion into pesos of the proceeds of foreign borrowing intended to defray the foreign cost component of projects were removed.

To provide exporters with access to credit at internationally competitive rates, the Central Bank has allowed direct and indirect exporters access to foreign currency loans from the Foreign Currency Deposit Units (FCDUs). In addition, it set up an exporters dollar facility funded out of its international reserves at internationally competitive rates.

At present, exchange rate is freely determined in the market. The Bankers Association of the Philippines set up the Philippine Dealing System, which links participants through an electronic screen-based network for sharing information and undertaking foreign exchange transactions.

As regards *foreign investment*, a foreign investment act was passed in 1991. It liberalizes entry of foreign investors within the provisions of the Philippine Constitution. As a general rule, there are no restrictions on the extent of ownership of export enterprises (defined as those exporting at least 60 percent of their output). As for enterprises oriented to the domestic market, 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 foreign investment act. The government further liberalized foreign investments in October 1994 by coming up with an empty

Negative List C of the Foreign Investment Act for the next two years.⁶ The rights provided to foreign investors under the existing laws are summarized in Table 6.

As part of its *competition policy*, the government dismantled entry barriers that protected incumbent firms in key industries, such as telecommunications industry, land, sea and air transport industry, banking industry, and cement industry. Since the liberalization of the telecommunications industry in 1992, several firms with foreign equity participation have entered the industry providing competition with the existing large monopolist. With the issuance in 1994 of a clear international satellite communications policy, two consortia of private telecommunications operators have been formed and are competing for the launching of the country's first satellite in December 1996.

Three major policy reforms have been introduced that have a direct bearing on *capital market development*. First, the double taxation of dividend income was eliminated through the abolition of the tax on intercorporate dividends and gradual phase out of the tax on shareholder's dividend income. Second, as part of the foreign exchange deregulation program, rules and regulations covering foreign investments in BSP-approved securities have been relaxed. Under the new rules, some of the functions of the BSP have been downloaded to the custodian banks to reduce red tape. It means that a foreign investor can immediately place his investment in BSP-approved securities, unlike before when he has to wait for a BSP approval, which usually took several weeks. Foreign investments duly registered with the BSP or with a custodian bank duly designated by the foreign investor are now entitled to full and immediate capital repatriation. Without prior BSP

⁶List A limits foreign ownership of certain economic activities as mandated by the Constitution and specific laws. List B limits foreign ownership of certain economic activities for reasons of security, defence, risk to health and morals and protection of small and medium-scale enterprises. List C covers areas under other legislations, administrative regulations and practices.

Table 6
RIGHTS PROVIDED TO FOREIGN INVESTORS UNDER THE EXISTING LAWS

1.	All investors and registered enterprises in the Philippines are entitled to basic rights and guarantees under the Philippine Constitution. These basic rights are the following:	
(a)	<u>Remittance of Earnings.</u>	Earnings from investments may be remitted in the currency in which the investment was originally made and at the exchange rate prevailing at the time of remittance.
(b)	<u>Foreign Loans and Contracts.</u>	Foreign exchange necessary to meet the payment of interest and principal on foreign loans and foreign obligations arising from technological assistance contracts may be remitted at the prevailing exchange rate.
(c)	<u>Repatriation of Investments.</u>	The entire proceeds of the liquidation of the investment may be remitted in the currency in which the investment was originally made and at the exchange rate prevailing at the time of repatriation.
(d)	<u>Requisition of Investment.</u>	The government will not take, by its authority, any property acquired by a registered enterprise or foreign investment. But in case of war or national emergency, the government has the right to requisition such property but only for the duration of the emergency. Just compensation shall be determined and paid either at the time of requisition or immediately after the war or natural emergency. Payments received as compensation for the requisitioned property may be remitted in the currency in which the investment was originally made at the exchange rate prevailing at the time of remittance.
(e)	<u>Freedom from Expropriation.</u>	There will be no expropriation by the government of the property represented by foreign investors or enterprises, except for public use or in the interest of national welfare and defense. In which case investors will be given just compensation. Foreign investors or enterprises shall have the right to remit the amount received as compensation for expropriated property in the currency in which the investment was originally made and at the exchange rate prevailing at the time of remittance.

Source:

Philippines Private Sector Assessment (PSA), July 12, 1994
Volume III: Annexes

approval, an authorized agent bank may sell and remit the equivalent foreign exchange representing sales/divestment proceeds or dividends/interest of duly registered foreign investment. While waiting for reinvestment or repatriation, divestment proceeds of duly registered foreign investment as well as cash dividends, interest payments and divestment proceeds of stock dividends/splits may be lodged in interest earning deposits, whereas before they were allowed to be placed only in government securities, shares of stock of BOI-registered industries and shares of stock in BSP-certified export-oriented industries with prior BSP approval. Brokers have pointed out that transactions related to foreign investment in CB-approved securities can now be settled in 3 to 4 days compared to 4 to 6 months under the old rules and regulations. All this will facilitate the inflow of portfolio investment into the country. Third, the two stock exchanges in the Philippines had been recently unified, thereby eliminating some inefficiencies (e.g., price arbitrage) in the stock market by having two stock exchanges listing the same shares.

The capital markets, particularly the equities market, have benefitted from the liberalization of foreign investment and foreign exchange market in the 1990s. Before 1990, the total capital raised in the exchanges was less than P10 billion and there were fewer firms listing their stocks in the exchanges. In the 1990s, the equities market soared to new highs as several large firms went to the exchanges to raise capital (Table 7). In 1994 alone, 22 firms raised capital amounting to P149.4 billion, which is more than the total capital raised in the past 14 years. Market capitalization jumped from 15 percent of GNP in 1990 to 79 percent in 1994. Industry analysts believe that there recently has been a shift in emphasis from debt financing to equity financing due to massive corporate projects (especially in telecommunications sector which was recently liberalized) and high cost of borrowing, not to mention the fact that many corporations have already reached their single

Table 7
Philippine Stock Market Profile
1980-1994, In Million Pesos

Year	Combined Turnover	Market Capitalization	G N P (Nominal)	Market Capitalization as % to GNP	No. of Newly Listed Stocks	Capital Raised
1980	4,700	26,432	243,270	10.87	3	220
1981	1,300	14,255	280,543	5.08	3	690
1982	1,200	18,172	313,544	5.80	8	1,292
1983	5,400	19,445	363,268	5.35	7	946
1984	2,100	16,846	508,485	3.31	1	315
1985	2,066	12,741	556,074	2.29	4	494
1986	11,470	41,214	596,276	6.91	7	734
1987	31,423	61,108	670,826	9.11	9	1,261
1988	18,251	88,591	791,822	11.19	6	3,060
1989	49,919	261,022	914,126	28.55	7	4,897
1990	28,531	161,219	1,078,408	14.95	10	18,537
1991	39,713	297,743	1,262,487	23.58	10	25,991
1992	76,627	391,231	1,385,562	28.24	11	22,143
1993	180,690	1,088,820	1,519,814	71.64	11	36,252
1994	362,268	1,386,464	1,751,485	79.16	22	149,381

Source: Research Department, Philippine Stock Exchange

Filename: TAD14STC

borrowers' limit with banks.⁷

ROLE OF EXTERNAL CAPITAL IN DEVELOPMENT

The Philippines has historically been a deficit country. Inevitably, mobilization of external capital has been resorted to to fill in the savings-investment gap. In the 1970s, the government borrowed heavily from external sources to finance several infrastructure projects. The private sector did the same mostly with government guarantee. The expansion of external debt was accelerated during the period 1979-1982 when the government undertook externally funded stabilization measures. In 1983, when the country could no longer service its external debt, the government declared a debt moratorium. As can be seen from Table 8, the debt service burden rose to 47.5% in 1994 and to 92% in 1995. The government had to enter into a debt restructuring arrangement with its creditors to reduce its debt service burden. Since then, the credit rating of the country had gone down tremendously, and it could no longer obtain financing from the international private capital markets. Foreign investment also dried up. Thus, the country became more dependent on official development assistance (ODA), both loans and grants, to stabilize the economy⁸ and to continue financing key development projects that have implications on the long-term growth of the economy. During 1986-1994 period, multilateral/bilateral loans comprised between 44% and 68% of the gross medium and long-term loans (Table 9).

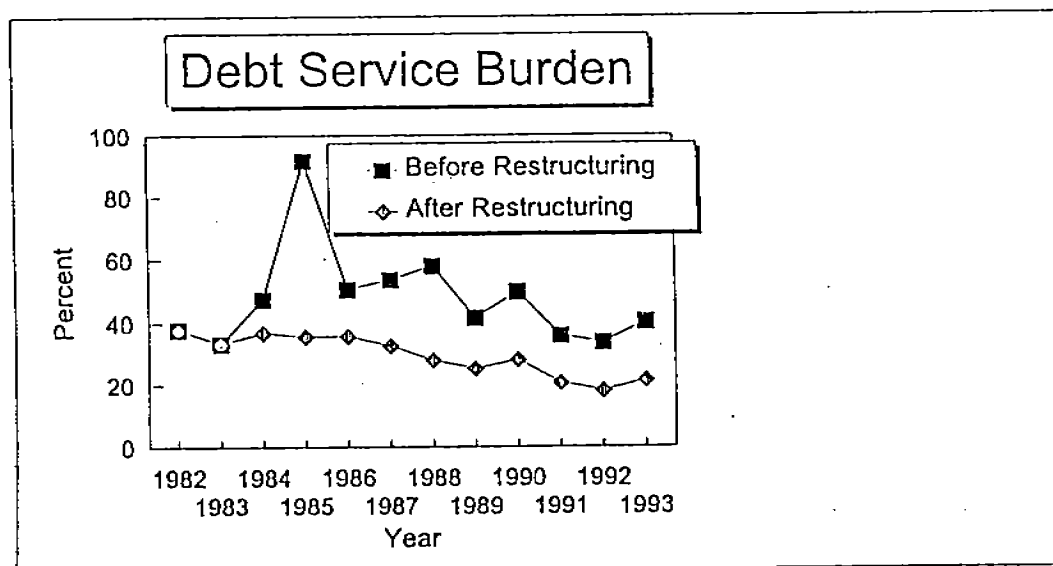
The second half of the 1980s was marked by very low foreign direct investment due to both

⁷The single borrowers' limit was recently increased by the Central Bank from 15 percent to 25 percent of the unimpaired capital of banks.

⁸That is, some ODAs were used for balance-of-payments and budgetary purposes

Table 8
Debt Service Burden
(% of Exports of Goods and Services)

Year	Before Restructuring	After Restructuring
1982	38.09	38.09
1983	33.50	33.50
1984	47.50	37.00
1985	91.95	35.75
1986	50.58	35.80
1987	53.60	32.76
1988	58.03	28.15
1989	41.59	25.30
1990	49.79	28.21
1991	36.11	20.69
1992	33.80	18.11
1993	40.39	21.53



Source: Bangko Sentral ng Pilipinas

Table 9
Capital Inflows/Outflows, 1986-1994
(In Million US Dollars)

	1986	1987	1988	1989	1990	1991	1992	1993	1994 ¹
I. Medium and Long-term Loans, Net	732	159	-519	381	406	922	666	2105	1364
A. Inflows	2605	2598	2412	2797	4321	3613	7436	4853	3877
of which:									
Multilateral/Bilateral	1291	1731	1563	1912	2370	2455	3312	2783 ₃	2485 ₂
(% of Inflows)	49.56	66.63	64.80	68.36	54.85	67.95	44.54	57.35	64.10
B. Outflows	1873	2439	2931	2416	3915	2691	6770	2748	2513
of which:									
Multilateral/Bilateral	843	1019	938	885	883	1125	1938	1823 ₃	1989 ₂
II. Foreign Investment, Net	140	326	986	843	480	654	737	599	1210
A. Inflows	186	439	1077	961	706	798	1364	3394	4646
of which:									
Foreign Direct Investment	17	34	81	93	171	130	234	334	735
(% of Inflows)	9.14	7.74	7.52	9.68	24.22	16.29	17.16	9.84	15.82
Portfolio Investment	13	21	51	386	152	227	566	2257	2724
(% of Inflows)	6.99	4.78	4.74	40.17	21.53	28.45	41.50	66.50	58.63
B. Outflows	46	113	91	118	226	144	627	2795	3436
of which:									
Capital Withdrawn	35	58	74	95	204	102	411	1360	1919
Portfolio Investment	0	2	1	14	0	15	115	1061	1224
III Short-Term Loans, Net	-824	80	-303	-89	19	369	350	-751	169
IV Errors and Omissions	33	-144	422	383	587	-151	-497	291	251
V. Total	81	421	586	1518	1492	1794	787	2244	2994

¹ January-November, 1994

² Values includes Rescheduling

³ Values includes Rescheduling from January-November only

political and economic instability. The return to political and economic stability and initiation of major economic reforms in the 1990s have made the Philippines attractive to foreign investors. Foreign investment, which is dominated by short-term portfolio investment, surged.

The sudden surge in portfolio investment, especially in the last two years, presented another problem to the authorities. Under very tight monetary ceilings stipulated in the IMF-sponsored stabilization program, the central bank had to sterilize its intervention in the foreign exchange markets, causing the domestic interest to rise. This, in turn, attracted more short-term portfolio investment, which added more pressure on the domestic currency to appreciate. The appreciation of the domestic currency, both in nominal and real terms, has weakened the competitiveness of Philippine exports and cheapened imports, thereby aggravating the trade balance deficit.⁹ The measures taken by the central bank, such as increasing the ceiling Filipino investors can invest abroad, combined with external factors, such as the Mexican crisis and the collapse of the Baring investment bank, somewhat reduced the speculative money going into the Philippines.

SOME RECOMMENDATIONS

For lack of space, we will discuss here only a few major recommendations that the Philippine government could take or other governments to consider when they liberalize their economies.

First, proper sequencing of the reforms can contribute much to a successful liberalization program. In this regard, domestic resource mobilization must be given top priority. In the Philippines, the low level of resource mobilization had been used by interest groups to block or delay

⁹See Lamberte (1994) for a detailed discussion on this issue.

the implementation of meaningful reforms.¹⁰ It also weakened the capability of the government to stabilize the economy whenever external shocks occur, as shown in the case of the Gulf War and sudden surge in portfolio investment.

Second, short-term stabilization program should be flexible enough to accommodate new developments so that the long-term growth of the economy can be assured. In the Philippines, the inflexibility of the monetary program in the face of surges in foreign capital caused an unnecessary appreciation of the domestic currency, which undermined the competitiveness of exports that has been one of the major objectives of the reforms. The resulting high domestic interest rate discouraged long-term investment and encouraged short-term speculative investment.

¹⁰Examples are: abolition or reduction of financial intermediation taxes, taxes on financial instruments, tariff rates reduction, liberalization of bank entry, etc.

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