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Philippine Institute for Development Studies

Scenarios for Economic Recovery: The Philippines

Mario B. Lamberte and Josef T. Yap

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SCENARIOS FOR ECONOMIC RECOVERY: THE PHILIPPINES

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Final Draft

5 February 1999

Philippine Institute for Development Studies

SCENARIOS FOR ECONOMIC RECOVERY: THE PHILIPPINE CASE

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SCENARIOS FOR ECONOMIC RECOVERY: THE PHILIPPINE CASE

I. GENERAL BACKGROUND

1. The Philippine Economy in the 1990s

During the period 1992-1997, the Philippines showed marked improvement in terms of macroeconomic stability (**Table 1**). Inflation was on a downward trend and the current account deficit was under control. Added to this was a rising M3/GNP ratio (**Figure 1**) which indicated a greater amount of savings flowing into the formal financial sector and the economy's increased ability to absorb credit into the system without generating inflationary pressure.

Fiscal policy was aimed at prudently managing the government fiscal position to support strong economic recovery and sustainable growth. Thus, reforms were made to broaden the revenue base, minimize, if not eliminate, fiscal distortions, and simplify the tax system to facilitate compliance. This fiscal stance had produced positive results. Tax yield increased from 15.3 percent in 1993 to 16.3 percent in 1997 despite substantial drop in customs revenue as a result of the tariff reforms. The national government had been running budget surpluses from 1994 to 1997. In 1996, the consolidated public sector account recorded a surplus for the first time in two decades.

The strategy adopted by the government to manage external debt had generated some desirable results. The ratios of debt service burden to export shipments, exports of goods and services, current account receipts and GNP had been declining during the period 1992-1996 (**Table 2**). The ratio of foreign exchange liabilities to GNP had also been declining while the ratio of gross international reserves to debt service burden had been increasing during the same period.

At the microeconomic level, firms realized comfortable profit margins, which were reinvested to expand their productive capacities. Some firms found the domestic capital market an attractive form of financing, creating a stock market boom. The stock market price index soared from 1256 in 1992 to 3170 in 1996. A few large corporations issued bonds in the international capital market at reasonable rates.

Before the liberalization of the financial sector, the financial system was highly segmented with sub-sectors focusing on a few financial services. Competition across types of banks was very minimal due to regulations. Only four branches of foreign banks were allowed to participate in the domestic banking system. Banks were prohibited from owning other types of banks. The liberalization of the financial sector started in the early 1980s with the introduction of universal banking and the blurring of distinction among different types of banks to improve competition. More measures to liberalize the financial sector were

introduced in the second half of the 1980s and the early 1990s (see **Appendix A – Table 1.**). Indeed, the liberalization of the financial sector had substantially changed the structure of the banking system. As of December 1997, there were 20 domestic universal banks, 16 ordinary domestic commercial banks, 1 branch of a foreign bank with a universal bank license, 13 branches of foreign banks, 4 subsidiaries of foreign banks, 117 thrift banks, 832 rural banks, 12 non-bank financial institutions with quasi-banking license, and 6,935 non-bank financial institutions without quasi-banking functions. The banking system had a total of 6,947 branches/other offices and the non-bank financial institutions, 3,021. Some universal and commercial banks have their thrift banks to have their presence felt both in wholesale and retail market. Many of them are active in both investment and commercial banking.

The economic growth realized by the Philippines in the 1990s, albeit modest compared to those of neighboring Asian countries, increased labor absorption and led to a reduction in unemployment rate from 10.5 percent in 1991 to 8.6 percent in 1996. Poverty incidence decreased from 39.9 percent in 1991 to 32.1 percent in 1997.

It was in this period, however, that economic managers faced new threats to macroeconomic stability and at the same time had to contend with old ones. The liberalization of the capital account in 1992 and the surge in global capital flows has significantly changed the parameters of macroeconomic policy making and financial regulations in the Philippines. **Table 3** shows the composition of foreign exchange flows of the country from 1990-1997 focusing on the capital account. Medium- and long- term (MLT) loans have been greater sources of financing than FDI, similar to the external borrowing episode in the mid- to late 1970s. Unlike that period, however, MLT loans in recent times have been primarily private sector debt.

FDI flows were dominated by debt conversions during the early 1990s and privatization proceeds especially in 1994 and 1995. This indicates that the Philippines is still a laggard in terms of attracting export-oriented FDI. Contrary to popular perception, portfolio capital on a net basis is relatively low although the level of gross flows rose sharply in recent years. The breakdown of portfolio capital reveals, however, that non-resident portfolio investment has been positive and increasing since 1991. The accumulated non-resident portfolio investment for the period 1991-1996 is slightly over US\$5 billion. Given that the foreign exchange reserves of the Bangko Sentral ng Pilipinas (BSP) hover around the US\$10 billion level, large and sudden movements in non-resident portfolio capital can have a tremendous impact on macroeconomic and microeconomic variables.

The experience in a number of Southeast Asian countries and Korea is that the periods of large net capital inflows were associated with rapid expansion in the banking sector, in their foreign liabilities, deposits, and domestic lending. The Philippine experience in the past three years seems to indicate a similar trend. The sharp rise in foreign liabilities of the commercial banks contributed to the rapid increase in loans and advances to the private sector and overall level of foreign debt (**Tables 3 and 4**). The rising proportion of the external debt intermediated through the private commercial banking system had increased the vulnerability of the banking system to adverse movements in the exchange rate. It is to be noted that the proportion of short-term external debt to total external debt rose

substantially in 1996 to 19 percent as against 14-15 percent in the previous years, making the country more vulnerable to sudden changes in the sentiments of foreign creditors. Foreign denominated loans, meanwhile, were distributed almost equally between exporters and non-exporters (**Table 5**). The lack of a natural hedge against foreign exchange risk for the latter contributed a great deal to the spread of the crisis.

The real estate sector was one of the beneficiaries of the economic growth in the 1990s. The stock market price index of the property sector rose by 200 percent during the period 1992 to 1996, higher than the 150 percent increase of the overall stock market price index for the same period.

The greatest challenge to macroeconomic managers is to minimize asset price volatility in the face of these capital flows. **Figure 2** shows that among the ASEAN countries and China, the Philippines had the highest appreciation of the real effective exchange rate between 1991 and 1996. Because of its sharp devaluation in 1994, China had a real exchange rate depreciation.

The extent of the appreciation may have been higher if BSP had not bought dollars in the market to increase demand for foreign exchange. This intervention, however, had limited effects because of International Monetary Fund (IMF)-imposed ceilings on monetary aggregates. The BSP had to sterilize the monetary effects of its dollar purchases in the market and this put upward pressure on domestic interest rates. This, in turn, attracted more capital inflows which partly offset the sterilization measures. Lamberte (1995) estimates the offset coefficient at 0.88 for the Philippines which is higher than the estimates for other countries (Leung 1996).

Sterilization measures also carried a quasi-fiscal cost owing to the interest differential between domestic and international interest rates. High interest rates also have a dampening influence on investment spending.

The most effective response to large foreign exchange flows is sustained prudent fiscal policy. It makes monetary policy more flexible and reduces pressure on domestic interest rate by reducing the public sector borrowing requirements. The challenge is how to maintain a tight fiscal policy without sacrificing much-needed public sector expenditures particularly in infrastructure.

In her review of fiscal policy for the period 1986-1996, Manasan (1998) commends the depth of fiscal adjustment during the last decade. From 6.6 percent of GNP in 1986, the consolidated public sector deficit reached a surplus in 1996 equal to 0.2 percent of GNP. She notes, however, that the bulk of fiscal adjustment in recent years was due to the large inflow of privatization proceeds. Capital outlays and government expenditures on maintenance and other operating expenditures (MOOE), which suffered major cutbacks during the adjustment period, have not been restored to their normal levels. With the impending sharp fall in tariff revenue following the tariff reduction program, it remains to be seen whether the fiscal position is sustainable. **Table 5a** shows the revenue performance over the past 10 years and projections until the year 2004. It seems that the national government is confident that it

would be able to compensate for the reduction in revenues from privatization and customs collections.

A cause for concern is the deterioration in the overall tax buoyancy coefficient from 1.41 in 1987-1992 to 1.15 in 1993-1996 (**Table 6**). Buoyancy measures the percentage change in tax yield given a percentage change in the tax base. The decrease is a reflection of less effectiveness in tax administration. The decline in buoyancy and the economic slowdown are the primary reasons why tax revenue dropped sharply in 1997 and 1998.

On the expenditure side, the unabated decline in MOOE and capital spending does not augur well for sustainable economic growth. Aggregate capital outlays of the national government shrank from 4.6 percent of GNP in 1975-85 to 2.9 percent in 1986-1991 before settling at 2.7 percent for the period 1992-96. Total public sector investment, however--incorporating the national government, government corporations and local government units--increased from 4.3 percent of GNP in 1986-91 to 5.2 percent from 1992-96. With the decision to reduce spending levels following the crisis, capital outlays necessary to improve infrastructure will fall further below the optimal rate.

A more detailed analysis of the structure of the Consolidated Public Sector Deficit (CPSD) reveals, however, that the government over-adjusted its fiscal position. Manasan shows that the actual primary surplus is consistently higher than a computed sustainable primary surplus. This condition holds even if transitory adjustments--which include temporary revenue measures, underspending on MOOE and capital outlays, and one-shot privatization receipts--are accounted for. The over-adjustment may actually reflect the prudent stance of the government following the debt crisis in 1984-1985 and its continuation should help in riding out the present crisis.

The over-adjustment of the fiscal position also implies that the public sector cannot be relied upon to contribute substantially to an increase in the saving rate of the economy in the future. Apart from fiscal prudence, the impact of foreign exchange flows can be mitigated by capital market deepening which will allow capital surges to be accommodated without resorting to raising domestic interest rates to temper the inflationary pressure. Capital market deepening, however, has to be supported by an increase in the level of domestic savings.

Two important implications arise from the previous discussion. First, that achieving a sustained fiscal surplus and increasing the domestic saving rate are medium-to-long term issues. They cannot be relied upon in case there is another surge in foreign capital inflows within the next few years. This puts a great deal of pressure on sound monetary policy. Second, that despite the underspending over the past decade, the new government has to grapple with a widening fiscal deficit. Emphasis, therefore, must be placed on the revenue side particularly on tax administration.

2. Export Growth and Industrial Structure

The Philippines was pointedly left out by the World Bank in its list of high powered Asian economies (HPAEs) largely because of the erratic growth path of its economy which

has been punctuated by boom-bust cycles. The performance of the Philippine economy during the post-war period has been directly linked to the fortunes of its industrial sector. The various studies on this sector came up with the following major conclusions (Medalla et al. 1995):

- a. That the more than three decades of protection had been very costly in terms of its inherent penalty on exports, its serious adverse impact on resource allocation, and dynamic efficiency losses arising from lack of competition;
- b. That a reform toward a more liberal and neutral trade policy is necessary to propel the economy to a higher level of industrialization.

The anti-protectionist-neoclassical view became dominant among government technocrats starting in the late 1970s and as a result a major trade reform program was implemented in 1980. The objective was to make the Philippines more outward oriented by opening up its economy. After the trade reform process was disrupted during the external debt crisis in 1984-85, major import liberalization programs were implemented from 1986-88. During this period, imports for more than 1,400 items were liberalized bringing down the percentage of import-restricted items to less than 10 percent.

This was followed by the second phase of the Tariff Reform Program which narrowed down the tariff range to mostly within 30 percent. This was implemented by the Aquino administration under Executive Order (EO) 470 which covered the period 1991 to 1995. Tariff reform was accelerated during the third phase of the program this time under the Ramos administration. EO 264 calls for a tariff range from 3 to 10 percent by the year 2000 and a uniform 5 percent tariff by the year 2004. Despite calls to reverse the policy direction because of the crisis, the administration of President Estrada has declared that it would continue with the programs initiated by the two previous administrations.

One reason for this is that based on empirical studies, the impact of the trade reforms is rather encouraging. Medalla (1998) shows that the average Effective Protection Rate (EPR) across all sectors declined from 44.2 in 1983 to 29.4 in 1990 to 24.1 in 1995. The gap in EPRs especially between agriculture and industry and between the exporting sector and the import substituting sector has been significantly reduced. Moreover, although exports remain penalized by the protection structure, the degree of the penalty has declined.

Partly because of the reforms in the trade sector, both total exports and the share of manufactured exports increased substantially. From only US\$4.8 billion in 1986, total exports surged to US\$25.2 billion in 1997 (**Table 7**). This represents an increase in the share of the Philippine exports in the world market from 0.24 percent in 1986 to 0.40 percent (in 1996) although it is lower than the share of the developing HPAs. The share of manufactured exports increased from 55 percent to 83 percent. Exports, however, are still concentrated in electronics and garments (at least up to 1993 for the latter) revealing a slow pace of change in the structure of the trade sector.

The deceptive export configuration explains why despite the increasing share of manufacturing in exports, the share of value added of this sector in total output has remained stagnant for the past twenty years and is even lower than the value in 1980 (**Table 8**). The year-on-year growth of value added in the manufacturing sector in real terms has actually declined for eleven consecutive quarters--from 1995Q4 to 1998Q2 (**Table 9**).

Medalla attributes the conflicting trends--a rise in efficiency measures in the manufacturing sector and continuing structural problems--to three factors: 1) adjustment, oftentimes a painful one, to a more open trade regime; 2) a persistently overvalued currency; and 3) the switch in relative protection between agriculture and manufacturing, this time in favor of the former. We could add to this list a relatively low investment rate in the Philippines and poor infrastructure.

An inevitable outcome of a more open trade regime is that inefficient local firms are weeded out almost immediately because of the deluge of imports. It will take some time before the resources are re-invested in more efficient sectors which are usually export-oriented. The restructuring process is akin to the "J-curve" effect of a currency devaluation. In this case, the manufacturing sector contracts because of the closure of noncompetitive firms but it should start to grow rapidly once resources are used more efficiently.

The restructuring process would have been smoother if the currency were allowed to depreciate in real terms following the increase in demand for imports. The lower value of the peso would have acted as a cover for import-competing industries. Because of the overvaluation of the peso, import-competing firms were hit with a double-whammy: lower tariffs and an artificially strong peso both of which made imports cheap. An overvalued currency could also explain why exports are heavily concentrated in commodities that are import-dependent. Because it is relatively cheap to import, exporters focus on products whose inputs can be sourced from abroad making labor the primary source of value added.

Overall, the Philippines has taken great strides to enhance its outward orientation and is bordering on being a completely open economy by the year 2004. This progression is dovetailed to the process of globalization. Despite the policy reforms, however, manufacturing growth has not performed up to expectations.

II. MACRO AND MICROECONOMIC IMPACTS OF THE CRISIS

Since June 1997, the peso has depreciated by about 50 percent vis-à-vis the US dollar and seemed to have stabilized around P40/US\$1. The Philippines was one of the countries that was spared the harshest effects of the crisis. The GDP growth rate is expected to be flat in 1998 but it would have been positive if not for the impact of the El Niño weather phenomenon. Inflation should be about 10 percent on average, a far cry from the 15-20 percent experienced as early as the Gulf War crisis in 1990-91. Interest rates as measured by the benchmark 91-day Tbill rate did not climb much higher than the 1996 and 1997 averages. Export growth has remained strong which could partly explain the current account surplus. Weak import growth, as a result of low demand during this crisis period, however, is still the main reason for the current account surplus.

On a sectoral basis, both industry and agriculture contracted for the first three quarters of 1998 (**Table 10**). Since the agriculture sector performance was a result of weather disturbances, it was the industry sector that bore the brunt of the financial crisis. This is quite obvious for the construction sector. In the case of the manufacturing sector, however, it was already experiencing trouble two years prior to the crisis. The Asian financial crisis merely exacerbated the situation.

Among the manufacturing subsectors that experienced the largest contractions are: transport equipment, rubber products, wood and cork products, textile manufactures and metal industries. Electrical machinery and furniture and fixtures experienced robust growth, an indicator that the export sector was instrumental in keeping the economy afloat. Food manufactures, which constitute about 45 percent of valued added in manufacturing, recovered from low growth in 1997.

The major concern for policy makers, however, is the fiscal deficit. From a surplus position for four consecutive years (1993-1997), the national government is projected to record a deficit in 1998. This reflects the sharp decline in revenue performance mentioned earlier. There are no short-term remedies for this situation except to temporarily reduce expenditures. Once the economy starts to recover, revenues are expected to rise, but to sustain this momentum reforms in tax administration should be implemented.

The slowdown in demand coupled with the sudden increase in the cost of money due to high interest rate and sharp depreciation of the peso had adversely affected several firms. From 1 January to 30 September 1998, 2,402 enterprises resorted to closure/retrenchment (**Table 11**). The overall stock market price index and the stock market price index for the property sector were reduced by half in recent months. It is to be noted that the leverage ratio of the top 1,000 corporations perceptively rose in 1997, suggesting that a significant number of them had foreign exchange liabilities (**Table 12**).

The plight of the corporate sector has adversely affected the balance sheets of banks. The non-performing loans of the banking system rose from 4 percent of total loans outstanding in June 1997 to 9.7 percent in June 1998.

The unemployment rate rose to 8.4 percent in January 1998 compared to 7.7 percent of the same month in 1997. As the crisis deepened, the unemployment rate rose further to 13.3 percent in April 1998 compared to 10.4 percent of the same month in 1997. The Department of Labor and Employment (DOLE) reported that for the first three quarters of 1998, the number of workers affected by establishment closure/retrenchment due to economic reason already reached 115,478. Given this situation, poverty incidence could have already risen above the 1997 level.

III. POLICIES AND MEASURES ADOPTED IN RESPONSE TO THE ASIAN CURRENCY CRISIS

The immediate concern of policy makers after the crisis erupted in Thailand was to ensure that the economic situation would not go out of hand and plunge the country into a downward spiral. Thus policy makers sought to stabilize the exchange rate and protect the soundness of the banking sector.

Fiscal measures were adopted in order to reign in the budget deficit that started to widen because of drop in revenue collection. These were also designed to support the prudent monetary policy at that time. Complementary measures in trade and industry and the social sector were implemented to prevent any policy reversal but at the same time protect the most vulnerable groups.

Measures to accomplish these objectives are discussed in detail below. The ultimate objective was to restore investor confidence in the economy.

1. Foreign Exchange Policy and Measures¹

When the Bank of Thailand announced in 2 July 1997 a managed float of the baht and called on the IMF for “technical assistance”, pressure on the peso started to mount. At the Philippine Dealing System (PDS), the average daily turnover increased to US\$255.8 million from an average daily turnover of US\$174 million before the onset of the Asian currency crisis.² The BSP intervened heavily in the foreign exchange market to defend the peso by increasing its dollar sales at the PDS. Thus, from 2 January to 11 July 1997, the BSP sold US\$5.05 billion or about 17 percent of the total volume of transactions, a sizeable proportion of which occurred during the first week of July 1997.³ By the end of July 1997, the gross international reserves (GIR) of the BSP dropped to US\$9.7 billion from US\$11.2 billion the previous month.

Sensing the ineffectiveness of these interventions on stabilizing the exchange rate, the BSP reduced its dollar sales in the foreign exchange market and announced on 11 July 1997 that it would let the exchange rate move in a wider band. By the end of July 1997, the peso depreciated to P29/US\$1 from P26.4/US\$1 a month ago. As pressure mounted on all Asian currencies, the peso continued to depreciate and reached a low of P43.9/US\$1 in August 1998. After 11 July 1997, BSP’s intervention in the foreign exchange market has been minimal, signaling to the market that it is adopting a new exchange rate policy.

While the exchange rate was left to the determination of the market, BSP adopted some measures to discourage market players, especially banks, from currency speculation in

¹ Most of these measures are presented in BSP, *The Philippines: Onward to Recovery*, July 1998.

² On 8 and 11 July 1997, the volume of foreign exchange traded at the PDS rose to US\$633 million and US\$619 million, respectively.

³ In April 1997, the BSP increased its dollar sales when strong pressure on the peso was felt.

the foreign exchange market and maintain the financial health of the banking system. These are discussed below.

Non-Deliverable Forward (NDF) Contracts

When the peso sharply depreciated in July 1997, the BSP became aware of the impact of non-deliverable forwards (NDFs) on the exchange rate. In particular, several players in the market had used NDFs to speculate on the exchange rate, which added pressure on the peso since the Asian currency crisis struck. To deal with this problem, the BSP issued a circular prohibiting banks from entering into NDFs with non-residents including offshore banking units without prior approval from it. The same circular also made it clear that only banks with expanded derivatives license can engage in NDFs.

Overbought/Oversold Position of Banks

In the aftermath of the Asian currency crisis, the BSP tightened the overbought position of banks while it relaxed the oversold position to discourage banks from speculating in the foreign exchange market and flush out dollars kept by banks. The overbought position was reduced from 20 percent to 5 percent of the bank's capital or US\$10 million, whichever is lower. On the other hand, the oversold position of banks was increased from 10 percent to 20 percent of the bank's capital. To prevent banks from circumventing this regulation by conducting foreign exchange transactions through their subsidiaries and affiliates, the BSP has required the consolidation of the banks' accounts with their subsidiaries and affiliates.⁴

The BSP increased the penalties on banks for failure to comply with the allowable overbought/oversold position of banks.

Over-the-Counter (OTC) Sales of Foreign Exchange

To prevent individuals and corporations from speculating in the foreign exchange market during the crisis period, the BSP reduced the OTC sale of dollars without need of any documentation from US\$100,000 to US\$25,000 in July 1997 and finally to US\$10,000 in April 1998. Those who want to purchase dollars from the banking system in excess of this amount will have to show documents that they have legitimate uses for such currency. Alternatively, they may purchase the same from the unregulated parallel market.

BSP's NDF Facility

Encouraged by the recent, relative stability of the exchange rate, especially in 1996, several corporations borrowed in foreign currency either from the international financial market or from the FCDUs of domestic banks without covering their foreign exchange exposure through some hedging instruments. When the peso depreciated sharply in July 1997, most of the unhedged corporations rushed to the spot market to buy dollars even if

⁴ Most domestic banks have their foreign exchange corporations which are registered with the SEC but not regulated by the BSP. These unregulated forex corporations buy and sell foreign exchange.

their foreign exchange obligations had not yet matured because of fears of additional depreciation. This situation added unnecessary pressure on the spot rate. Some of the corporations borrowed pesos from domestic banks to finance their purchases of dollars, which exerted additional pressure on the domestic interest rate.

To protect corporations with foreign exchange liabilities against currency fluctuation risk, the BSP created in December 1997 the Currency Rate Protection Program (CRPP), which essentially is a NDF facility. Settlement of the difference between the contracted rate and the market rate is done in pesos. Eligible foreign exchange liabilities include unsecured registered foreign currency loans, foreign currency trust receipts and customer liabilities booked locally before 19 December 1997 that are unhedged. Later on, loans of exporters were included as eligible to the CRPP.

Since the CRPP can spread the demand for dollars between the spot and forward market, therefore, it can also ease the demand pressure in both the spot market caused by corporate borrowers wanting to cover their foreign exchange exposure and the domestic interest rate.

The BSP could lose a lot of money in this program, especially if the peso sharply depreciates when a lot of the contracts matures. Losses of the BSP from this program can undermine its ability to manage liquidity of the system.⁵ However, a few months after the introduction of the CRPP, the peso started to appreciate vis-à-vis the dollar, which many analysts attributed partly to the success of the program. The demand for the CRPP facility subsequently died down. When the peso and other currencies in the Asian region sharply depreciated again in August 1997 following Russia's call for a moratorium on its external debts, the BSP re-activated the CRPP.

2. Monetary and Credit Policies

In conducting monetary policy, the BSP has been gradually reducing its reliance on traditional monetary tools, such as the reserve requirement ratio and the rediscount window, and has increased its reliance on open market operations. In view of the huge inflationary impacts produced by previous sharp devaluations of the peso, especially in the mid-1980s, the BSP quickly put in place some measures to control liquidity growth of the system. These are:

Open Market Operations

The BSP adjusted its overnight borrowing rate to as high as 32 percent per annum on 11 July 1997. In the following month, the BSP temporarily suspended its overnight lending facility to prevent banks from using BSP loans to speculate in the foreign exchange market. As financial system began to stabilize, the BSP gradually reduced its overnight borrowing rate and reopened its overnight lending facility. As at end-September 1998, the overnight

⁵ This is reminiscent of the old central bank's operations in the early 1980s.

borrowing rate of the BSP posted at 16 percent per annum and the overnight lending rate at 18 percent per annum.

Required Reserve and Liquidity Requirements

The BSP had been gradually reducing the statutory reserve on bank deposits from of high of 25 percent in 1990 to 14 percent in January 1997. Twenty-five (25) percent of the statutory reserves was supposed to be kept in the form of below-market, interest-bearing deposit at the BSP and the rest at the bank's vault.

The BSP has maintained its policy of gradually reducing the statutory reserve, which now stands at 8 percent. However, in view of the need to control liquidity growth and, at the same time, reduce the bank's intermediation cost during the crisis period, the BSP made a series of increases in the liquidity reserves, which reached a high of 8 percent in August 1998.⁶ This was brought down to 4 percent in November 1997, but was raised again to 7 percent in March 1998 in exchange for the reduction in statutory reserves from 13 percent to 10 percent. Since October 1998, the statutory and liquidity reserves stand at 10 percent and 7 percent, respectively.

To reduce further the bank intermediation cost, the BSP increased the proportion of the interest-bearing statutory reserves from 25 percent to 40 percent in May 1998.

Table 13 shows the liquidity and credit growth rates from 1990 to June 1998. Liquidity growth rate drifted upward during the second semester of 1997 as the BSP accommodated loans to some banks which encountered liquidity problems. It was, however, brought down in the first semester of 1998. What is worrisome though is that the growth in bank loans would likely be flat for 1998, notwithstanding the continued decline in the domestic interest rate. This can be attributed to both the demand and supply factors. On the demand side, the corporate sector had slowed down their production activities due to the decline in the demand for their products during the crisis period and resorted to running down their inventories to meet sales orders. On the supply side, banks have been extra cautious in making new loans due to the lingering uncertainty in the financial market. Banks have reduced the amount of loans made available even to some of their long-time customers because of the deterioration in the quality of the collateral being offered. Thus, banks are awash with cash and they have nowhere to place them but in foreign exchange or in risk-free government securities. As can be gathered from the auction results since July 1998 (**Table 14**), the dealers' tenders for government securities have always exceeded the volume accepted by the Bureau of the Treasury by a wide margin.⁷

⁶ The BSP started in December 1993 to impose a 2 percent liquidity reserve on deposits, which banks can keep in the form of short-term, market-yielding government securities purchased from the BSP.

⁷ Most government securities dealers are also banks or their affiliates/subsidiaries.

3. Banking Sector Restructuring

The Philippine financial system entered the July 1997 Asian financial crisis on a much firmer ground than those of its Asian neighbors. This was because it had undergone a massive restructuring in the 1980s and 1990s partly as a result of changes in banking policies and regulations (e.g., creation of universal banks, liberalization of bank entry and branching, removal of interest rate ceilings, etc.) and partly as a result of the severe crises it had experienced in the mid-1980s which led to the weeding out of badly managed banks, investment houses and finance corporations. As can be gathered from **Table 15**, non-performing loans (NPLs) of the banking system soared to 23 percent of total loans outstanding in 1985. The following year, loan-loss provisions of banks went up to 20.6 percent. From 1981 to 1987, the central bank closed 173 banks including 6 medium-sized banks, leaving strong banks to continue operation. Since then, banks have been cleaning their balance sheets. Thus, in June 1997, the banking system's NPLs stood at 4 percent only and loan-loss provisions to 1.4 percent.

The incidence of the cost of the closure of several financial institutions in the mid-1980s fell heavily on the government as it absorbed a sizeable amount of the liabilities of the failed banks, investment houses and finance corporations and paid depositors the insured deposits (Lamberte 1989). Some banks were nationalized, and it took the government some time to re-privatize them. The proceeds from the privatization of some financial institutions were significantly less than the cost the government incurred when it absorbed the liabilities of the failed financial institutions. Because of its sad experience in assisting ailing banks in the 1980s, the government has been very cautious in intervening and providing financial support to ailing banks. It also prompted the government to strengthen its prudential rules and regulations and improve the technical capabilities of bank examiners.

The financial crises in the mid-1980s had taught Philippine financial institutions the value of prudent financial management. However, the liberalization of bank entry and branching of domestic banks in the late 1980s and the liberalization of the entry and scope of operations of foreign banks saw increased competition in the financial system. The economic recovery in the 1990s provided banks with a lot of profitable opportunities. Bank loans grew by 32 percent on average during the period 1992-1996, peaking at 40.5 percent in 1996. For commercial banks alone, the share of its loans to total assets increased from 42 percent in 1990 to 58 percent in 1996 (**Table 16**). What is worth noting though is that the ratio of foreign currency loans of the commercial banking system to the total assets of its foreign currency deposit system rose from 20 percent in 1990 to 55 percent in 1996. Clearly, banks' exposure to credit and currency risk had increased during the last six years. A sharp downturn in the economy could surely weaken the balance sheets of many banks. Because of this, the central bank introduced some prudential measures to maintain the financial health of individual banks. These measures could also lead to a restructuring of the financial system. These will be discussed in this section.

Cap on Real Estate Loans

The vulnerability of the real estate sector to sudden downturn in the economy is amply demonstrated by the halving of its market price index in 1997.

A few months prior to the Asian currency crisis struck, the BSP had already been closely monitoring banks' exposure to the real estate sector. In June 1997, it finally placed a cap on banks' loans to the real estate sector equivalent to not more than 20 percent of a bank's total loan portfolio, exclusive of loans to finance the acquisition or improvement of residential units amounting to not more than P3.5 million. This is aimed at moderating the growth in banks' financing of the construction of high rise buildings, some of which were built by developers and purchased by investors for speculative purposes. However, the bank's aggregate loans to the real estate sector inclusive of loans to finance the acquisition or improvement of residential units are not to exceed 30 percent of its total loan portfolio.

In addition, the BSP reduced the loan value of the real estate used as collateral for bank loans to not more than 60 percent of the appraised value of the real estate property, exclusive of individual loans not exceeding P3.5 million.

The banking system's exposure to the real estate sector turned out to be much less than the cap imposed by the BSP (**Table 17**). Nonetheless, some banks, especially thrift banks, which had heavy exposure to the real estate sector encountered some financial difficulties during the Asian currency crisis. Thrift banks are quite different from commercial and universal banks in that they tend to specialize in housing and SME loans – the two sectors that are highly vulnerable to sudden downturn in the economy.

30 Percent Liquid Cover on All Foreign Exchange Liabilities of FCDUs

As pointed out above, the banking system's foreign exchange intermediation increased significantly during the 1990s. The relative attractiveness of foreign exchange deposits and loans of FCDUs over peso deposits of banks can be attributed to the relative stability of the exchange rate in the 1990s and tax advantages. More specifically, the interest income of banks from foreign exchange loans of their FCDUs are not subject to the 5 percent gross receipts tax imposed on interest income from peso loans. Likewise, interest income on foreign exchange deposits was not subject to the 20 percent withholding tax, until 1997 when the government started to impose a 7.5 percent tax on such income as part of its comprehensive tax reform.

Although banks are fully hedged when they lend in foreign currency from their FCDUs because they also expect payment in the same currency, their borrowers may be exposed to currency risk and may default on their loans if the exchange rate unexpectedly moves in the other way. Due to pressure on the exchange rate experienced by the Philippines during the second quarter of 1997, the BSP in June 1997 required that 30 percent of the 100 percent cover on all foreign exchange liabilities of FCDUs of banks be kept in liquid assets.

As a result of the above-mentioned regulation, the general slowdown in the demand for loans and the shift towards peso-denominated loans made by the corporate sector due to increased exchange risk, the share of FCDU loans in the total assets of FCDUs dropped significantly from 55 percent in 1996 to 46 percent in 1997 and remained at this level up until April 1998 (**Table 16**).

Treatment of Past Due Loans

The BSP has tightened the definition of past due loans. Before the latest revision in the definition of past due loans, loans were treated as past due if the number of installments in arrears reached six in the case of loans payable on a monthly basis and two in the case of loans payable on a quarterly basis. Starting October 1997, the number of installment in arrears was reduced to three and one, respectively (**Table 18**).

The other provision that banks must consider is that when the total arrearages reach 20 percent or more of the outstanding balance of the loan, the outstanding balance is already considered past due regardless of the number of unpaid installments. This will prompt banks to immediately take remedial actions on problem loans before they become worse and irrecoverable.

Indeed, part of the rise in NPLs of banks since October 1997 can be attributed to the change in the definition of banks.

General and Specific Loan Loss Provisions

As a ratio to total loans, loan-loss provisions of the banking system started to creep up since the onset of the Asian currency crisis in tandem with the rise in NPLs. It already reached 2.8 percent of total loans in June 1998.

In the past, the BSP had only specific loan-loss provisions. Since October 1997, the BSP is requiring banks to put up a 2 percent general loan-loss provision, which is over and above the specific loan-loss provisions. The schedule of compliance of the general loan-loss provision is shown in **Table 19**.

As regards specific loan-loss provisions, only “substandard loans that are unsecured”, “doubtful loans” and loans classified as “loss” had specific provisions. In April 1998, the BSP started to tighten the specific loan-loss provisioning. It has prescribed a 5 percent loan-loss provision for “loans especially mentioned” regardless of collateral. These are loans which are potentially weak in view of some technical defects or collateral exceptions, such as inadequate documentation. The BSP has also prescribed a 25 percent provision for secured loans classified as “substandard loans”. Thus, there is no more distinction between substandard loans that are secured and those that are unsecured. The schedule of compliance for the new specific loan-loss provisioning is shown in **Table 20**.

With these new regulations on loan-loss provisioning, banks loan-loss provisions are expected to increase further both in absolute terms and as ratio to total loans outstanding,

affecting the profitability of banks. One of the biggest issues here is the giving of the same weight to collateralized and uncollateralized substandard loans. Both are essentially given equal probability of default when in fact the moral hazard problem of a collateralized loan is much less than that of an uncollateralized loan.

Increase in the Minimum Bank Capitalization Requirement

The BSP has been intermittently increasing the minimum capitalization requirement of banks. Because of the sharp depreciation of the peso and possible deterioration in the assets of banks as the Asian currency crisis proceeds, the BSP decided in March 1998 to increase the minimum capitalization of new banks by 20 percent for universal banks (or expanded commercial banks), 40 percent for regular commercial banks and 60 percent for rural banks. Existing banks are given two years to build up their capital to comply with this new requirement (**Table 21**).

The BSP issued a circular imposing strict penalties on banks for failure to comply with this new minimum capital requirement. In particular, a universal or commercial bank unable to comply with the new minimum capital requirement will be slapped with penalties as high as P10,000 per day, computed from the time it is notified by the BSP to the time the program has been submitted. Thrift banks will be fined P5,000 per day and rural banks P1,000 per day.

In addition, the BSP shall impose graduated sanctions on banks for non-compliance of the new minimum capital requirement. The BSP will take prompt corrective actions on banks that are undercapitalized up to 20 percent; another set of prompt corrective actions on banks that are significantly undercapitalized up to 60 percent; and still another set of prompt corrective actions on banks that are critically undercapitalized by more than 60 percent.

Banks have several options to choose from to comply with the new minimum capital requirement. One is to raise more capital either by asking contributions from stockholders or inviting new stockholders or partners. Another option is to merge with other banks. Still another option is to apply for a reclassification, i.e., change to another type of bank that has lower minimum capital requirement.

This new minimum capital requirement could lead to a restructuring of the banking system. There will be merger and/or consolidation, especially among small and medium-sized commercial and thrift banks, which will result in the reduction in the number of banks in the system. The sharp depreciation of the peso has made it very attractive to foreign banks or investors to invest or increase their equity participation in domestic banks.

Of the 24 domestic universal banks, 5 have capital below the new minimum capital requirement that will take effect on 24 December 1998 (**Table 22**). On the other hand, half of the 16 domestic commercial banks still need to build up their capital to meet the new minimum capital requirement. All four subsidiaries of foreign banks need to raise capital to hurdle the new minimum capital requirement.

The Chamber of Thrift banks reported that more than 50 percent of their members are already in conformity with the new minimum capital requirement. It is likely that most of them are affiliates or subsidiaries of universal or commercial banks.

Some domestic banks have already intensified their campaign to raise more capital from their stockholders and/or by inviting foreign banks or investors. Others have been contemplating of merging or consolidating with other banks. So far, two banks, one a universal bank and the other an ordinary commercial bank, have formally secured approval from their stockholders for a merger and are in the process of seeking approval from the BSP. Another two universal banks have already formally agreed to merge and will soon be securing approval from the BSP.

Other banks have so far been unsuccessful in raising capital from existing stockholders or new foreign investors. Existing stockholders and foreign investors are still cautious in investing in banks because of the lingering effects of the Asian currency crisis. Other investors who are optimistic are constrained from investing because they want more shares than the local existing stockholders are willing to sell. Recently, one universal bank decided not to pursue its capital build-up program anymore and instead revert itself to a regular commercial bank. It has, however, to reduce its equity in an investment firm because commercial banks are allowed only up to 40 percent equity participation in such allied undertaking. This is not easy to do considering that investors' interest in such undertaking is still low in view of the continued economic uncertainty. Other universal banks may follow suit if they cannot find a way of raising more capital. On the other hand, one branch of a foreign bank with a regular commercial bank license has applied for a universal banking license. It has signified its intention to raise its capital to meet the new minimum capital requirement for universal banks.

Some thrift banks that are facing difficulty in complying with the new minimum capital requirement are contemplating of converting themselves into a rural bank. Others are offering themselves to be bought by commercial banks. However, the lessons that can be learnt from the recent experience suggests that size, i.e., sufficiently capitalized banks, is important buffer to deal with financial crisis. Thus, as a result of the on-going restructuring of the banking system, a much leaner banking system in terms of number of banks but with much stronger balance sheets will likely emerge.

Rules on Disclosure

In March 1998, the BSP tightened rules on disclosure to improve bank transparency to the public, in general, and to their stockholders, in particular. Beginning in the last quarter of 1998, banks listed in the stock exchange are required to disclose in their quarterly published statement of condition the amount of non-performing loans and ratio to total loan portfolio, amount of classified loans, general loan-loss provisions and specific loan-loss provisions. The BSP will determine later if such rule need to be extended to non-listed banks.

Another directive issued by the BSP in June 1998 requires banks to include in their consolidated statement of condition the following information: current level of restructured loans both with and without uncollected capitalized interest; and total loan-loss reserves which include the 2 percent general provisioning and the provisioning for losses on loan accounts and other risk assets.

Some banks oppose these new disclosure rules for fear that their depositors and the general public might misunderstand the figures, particularly on NPLs, which are seen to be rising since the onset of the Asian currency crisis, and cause a run on banks. The new disclosure rules could also place thrift and rural banks at a disadvantageous position because they have historically shown to have higher NPLs than commercial banks, and thus may be perceived by the public as generally unsafe and unsound types of banks. This likely be a hotly debated issue in the coming months when the BSP deliberates on the extension of the new disclosure rules to all banks, whether listed or unlisted in the stock exchange.

Terms on Emergency Loan Facility

Under existing law, the conditionalities for emergency loans include: maintaining the total volume of loans or investments of the borrower; making the Monetary Board ascertain that the bank is not insolvent and has the assets to secure the advances; and that loan is only up to 50 percent of the bank's deposits which will be released in two tranches.

Since July 1997, a number of banks, mostly thrift banks, have tapped the emergency loan facility of the BSP to tidy up their liquidity problems. Thus, the outstanding emergency loans, excluding overdraft, provided by the BSP to banks ballooned to P13.4 billion in September 1998 from only P1.1 billion in June 1997.

Since October 1998, the BSP has tightened the terms of emergency loan by adding to the existing conditionalities the following requirements: the emergency loan should be used only to service withdrawals of deposits; bank directors, officers, shareholders, and related interests (DOSRI) submit written agreement not to withdraw their deposits from the bank; and a BSP comptroller will be assigned to the bank to see to it that all conditions are met. To ensure compliance of these rules, the BSP will require bank owners to waive their rights to the deposit secrecy law. These new requirements are intended to ensure that bank owners will not abandon their bank once it gets into financial trouble.

Insiders' Borrowings

Unpaid loans of directors, officers, stockholders and related interests (DOSRI) were often the cause of bank failures. Bank supervisors found it hard to detect abuses on DOSRI loan limit due to the deposit secrecy act.⁸ Some of the DOSRI loans were made through dummies. To address this problem without changing the deposit secrecy law, the BSP issued a circular in August 1998 stipulating that all directors, officers, shareholders and related

⁸ Aggregate DOSRI loans should not exceed 15 percent of the total loan portfolio of the bank or 100 percent of networth of the bank. There is also a single borrower's limit of 25 percent of a bank's unimpaired capital.

interests who borrow from their banks shall be required by the lending bank to waive the secrecy of their deposits of whatever nature in all banks in the Philippines. However, any information obtained from an examination of the deposits will be held strictly confidential. This measure will hopefully aid in exposing dummy borrowers of banks.

Some bankers have pointed out that requiring an examination of all of the borrower's accounts in other banks could affect the banking sector's ability to attract deposit. As a compromise, they are suggesting that the BSP limits the examination of the borrower's account only in the bank he is borrowing from because it is enough to discourage abuse of DOSRI loan limit.

Temporary Suspension of Giving Derivatives License

In the Philippines, banks need to secure authorization from the BSP to engage in derivatives activities. Since the issuance in 1995 of the conditions for banks to obtain a license for derivative activities, 11 banks obtained authorization to conduct expanded derivatives activities and 1 regular derivatives activities.⁹ The last license given by the BSP to a bank was in March 1998. Since then, the BSP has suspended the granting of expanded derivatives licenses to banks to give applicant banks more time to prepare themselves for trading derivatives.

Since the derivatives market in the Philippines is still in its infancy, said BSP policy will have no perceptible impact on the market. However, it will give itself ample time to review the performance of banks in the derivatives market and determine which ones should be retained before allowing new players in this market.

Mark-to-Market Reporting

The BSP issued a circular stipulating that effective 30 September 1998, banks are required to mark-to-market their trading portfolio in line with existing market conditions, and any unrealized or realized gains and losses thereof shall be recognized and reflected in their books. While mark-to-market scheme is a standard practice among foreign banks, this is however something new to local banks. Thus, the latter will have to set guidelines to their traders on limits on positions to carry.

After two months of implementation, the mark-to-market scheme has already significantly affected the funding strategies of banks. One of the domestic universal banks recently admitted to incurring losses amounting to about half a billion pesos due partly to its complying with this new regulation.

⁹ According the BSP circular on derivatives, derivatives include forward foreign exchange transactions. A regular derivatives license authorizes a bank to deal in currency swaps and forwards, while an expanded derivatives license authorizes a bank to deal in all types of derivatives.

Policy Guidelines in Resolving Problem Bank Issues

Due to come criticisms lobbied against the BSP by some quarters for lack of clarity in dealing with problem banks as amply exemplified by the case of one commercial bank that had been allowed to declare a bank holiday for eight months before finally closing it, the BSP issued in August 1998 a circular letter spelling out its policy in resolving problem bank issues. In particular, the BSP may explore alternatives to bank closure within the limits allowed by law if, based on its judgment, the closure of a particular bank will most likely lead to a systemic crisis. In making such judgment, the BSP shall take into account, among other things, the size of the bank and its relative importance to the banking community such that its closure could undermine confidence in the system. The possible solution can include rehabilitation of the troubled bank and merger or consolidation with another financial institution. If there are strong indications that the bank failure may have been caused by wrongdoings of management, the BSP may impose conditions that will operate vis-à-vis the troubled bank and/or its owners and management, including but not necessarily limited to the following:

- (a) There shall be total divestment of equity interest of the principal stockholder(s) in the bank with the purchase of the share by a new investor;
- (b) Not a single centavo shall be given to the present stockholders from the proceeds from the sale of shares;
- (c) Proceeds of the sale including premium thereof shall be applied to raise the capitalization of the bank to the minimum required level and to reduce outstanding loans, if any, to the bank's stockholders and their related interests;
- (d) The bank's stockholders shall not be elected as a member of the board of directors or be involved in the management of the rehabilitated bank; and
- (e) Criminal and administrative sanctions, if warranted, shall be imposed upon the erring stockholders, directors and officers.

If no viable options can be found, the option of placing banks under receivership by the Philippine Deposit Insurance Corp. (PDIC) shall be considered subject to existing laws.

In 1997, the BSP closed a total of 14 small banks including 1 thrift bank. Five of them were closed after July 1997. In 1998, the BSP closed 1 small commercial bank, 6 thrift banks and 17 rural banks. The deterioration in the financial conditions of these closed banks cannot be mainly attributed to the recent downturn in the economy but rather to imprudent management practices. In other words, with or without the crisis, these banks could have suffered the same fate. Admittedly, however, there were at least three medium-sized thrift banks whose loans were concentrated in the real estate sector that experienced difficulty when the real estate sector plunged following the Asian currency crisis. With the assistance of the BSP, they were quickly bought out by other banks.

4. Fiscal Policy

The slowdown in the economy following the Asian currency crisis was expected to adversely affect the government revenues, threatening the fiscal position of the government. Thus, the government slapped a 25 percent mandatory reserve on the 1988 budgets of all government agencies and a 10 percent cut in the Internal Revenue Allotment of local government units to contain the budget deficit. As the crisis deepened and a recession became imminent, the government changed its stance to that of pump-priming the economy. It targets a P40 billion deficit in 1998, which is equivalent to 2 percent of GNP, although the IMF agreed a much higher deficit of P49 billion under the standby loan arrangement.

The Estrada administration appeared to be quite slow in disbursing funds in its first few months in office, making a lot of people doubt about its seriousness in pump-priming the economy. However, the last two months in 1998 saw the budget deficit nearing its target level, indicating that the government had already released funds to finance its pump-priming activities.

5. External Debt Management Policy

The ratios of debt service burden and foreign exchange liabilities to GNP deteriorated in 1997 as a result of the sharp depreciation of the peso and slowdown of the economy starting in the second semester of the same year (**Table 2**). The ratio of gross international reserves to debt service burden, which had been increasing up until 1996, sharply declined in 1997 as a result the substantial reduction in the gross international reserves, which had been used by the BSP partly to defend the peso.

In view of its policy to keep domestic interest rate low and, at the same time, finance a higher budget deficit to pump prime the economy, the government had announced that it would intensify its borrowings from ODA facilities, which are long-term loans carrying highly preferential rates. Before the onset of the financial crisis, the government wrapped up a US\$1.44 billion standby loan agreement with the IMF which would enable it to draw down US\$280 million in November 1998 and US\$135 million in December 1998. The government also secured a US\$1 billion pledged from the World Bank, of which US\$600 million package of loans is expected to be approved in December 1998.

The government planned to float bonds in the international capital market, but it temporarily shelved it because of the widening in the spreads on Philippine debt papers. It intends to push through with the plans during the first quarter of 1999. In the meantime, the government secured in September 1998 a one-year US\$610 million bridge financing from the FCDUs of domestic banks for budget support. However, this raises two problems. One is that FCDU deposits are typically short-term funds, making the extension of such loans at the same interest rate of 8.75 percent difficult to do especially during periods of economic instability. The other is the possibility that the government will later on use ODA funds to pay the short-term bridge financing when the loan matures next year, leaving a smaller amount of ODA funds to support the rehabilitation and restructuring of the economy.

6. Industrial and Trade Policy¹⁰

In general, the government is maintaining its policy of moving towards a uniform 5 percent tariff rate by 2004 despite the financial and economic crisis affecting the Asian region. However, there were new developments in trade and industrial policies in the country since July 1997.

EO 465 was issued in 13 January 1998 modifying the nomenclature and tariff structure of 22 industries identified as “*Philippine winners*”. These are the industries which have proven to be competitive or with some potentials. EO 465 was the result of the review of the pace of tariff reduction under EO 264 in consideration of the recent developments in the domestic and international economic environments. The review aimed to correct the remaining distortions in the tariff structure and to smoothen the pace of schedule of tariff reduction to deserving industries. The recalibration of the tariff structure was based on the pace of liberalization in other ASEAN countries and whether or not an industry has potentials or has proven to be competitive.

The “Philippine winners” include electronics, garments and textiles, metal products, processed foods, marine products, furniture, jewelry, holiday decors, seaweeds and carageenan, ceramics, marble products, basketwork, footwear, leather goods, fresh fruits, oleochemical products, fertilizer, copper products, petrochemical products, motor vehicle parts and components, iron and steel products, and industrial tree plantation products including rubber products.

The rates of duty for certain tariff lines were either raised or reduced under EO 645. Other tariff lines had the same rate as set under EO 264. **Table 23** shows the number of tariff lines affected in each category. It should, however, be noted that EO 465 was not designed to delay the attainment of a uniform tariff rate by 2004. While it resulted to the small increase in the overall average nominal tariff rate from the pre-EO 465 level (**Table 24**), the overall effective protection rate went down (**Table 25**).

The government issued on 7 December 1998 the implementing rules and regulations (IRR) of Republic Act (AFMA) No.8435 or the Agriculture and Fisheries Modernization Act of 1997. The law provides for the duty-free importation for five years from the date of its effectivity of farm and fishery commodities, machinery and equipment to modernize the agriculture and fisheries sector and enhance the incomes of farmers and fishermen.

The agriculture and fisheries inputs, machinery and equipment eligible for tariff exemptions are classified into two groups. The *first group*, covering 118 product lines, is exempted from the rules on the application/certification and monitoring procedures as provided for by the IRR. Some of these products include pure-bred breeding animals for cows and buffaloes, swine, goats, chickens, turkeys and other live animals; bovine semen or

¹⁰ Myrna Austria, PIDS Research Fellow, provided this section.

sperm; farm tools ranging from knives and cutting blades to tractors and parts, conveyors, refrigerated vans and hay-making machinery.

The *second group*, the list of which will be issued within 30 days from the effectivity of the IRR, covered products that are subject to application and certification procedures, like certificate of eligibility from the Department of Agriculture or its deputized agencies.

The list under each group will be reviewed at least once per semester until 31 December 2002 by the Department of Agriculture in consultation with concerned private and government institutions.

The IRR also provides for the need to monitor the domestic market to guard against the diversion of imports for resale in the domestic market.

7. Social Safety Net

The 25 percent budget cut on the 1998 budget would mean, among others: a reduction in new classrooms by 2,567 affecting 158,265 elementary and secondary public school students; new desks will be reduced by 59,353 affecting 118,706 students; 1,428 classes will not be provided with instructional materials; the malaria control program will cover 27.5 percent less than targeted; the tuberculosis program will cover only about 2/3 of its original targets; and the coverage of the Nutrition Program will experience a reduction in target beneficiaries by 436,090 children for Vitamin A, 749,893 women for iodine, and 166,667 pregnant women for iron (Virtucio 1998).

To mitigate the social impact of the Asian currency on the Philippines, the Estrada administration lifted in July 1998 the 25 percent budgetary reserve imposed on the appropriation for maintenance and other operating expenses (MOOE) for critical basic health and social services programs aggregating P1.5 billion. This was followed by the lifting and release of the budgetary reserve imposed on national government subsidy for additional operational requirements for four specialty hospitals, as well as the reserve imposed on their 1998 corporate operating budget. It also partially lifted the reserves imposed on the internal revenue allotment of local government units.

As regards labor relations, DOLE together with the employers' and labor groups hammered out a social compact, called Social Accord for Industrial Harmony and Stability, which commits employers to exercise utmost restraint in the lay-off, termination or rotation of their employees and labor to exercise utmost restraint in declaring or going on strikes, slowdown of work and other forms of concerted work stoppages. Without this social compact, the number of laid off workers could have been much higher than what was mentioned above and there could have been more disturbing labor strikes, making it doubly difficult for firms to make the necessary adjustments during the crisis period.

8. Political Stability

The Aquino administration restored democratic system of government and the democratic institutions in the country to support a predominantly market-oriented, private sector driven economy. The Ramos administration consolidated these gains and pushed for major and radical reforms, such as squarely dealing with various rebel groups using the Social Reform Agenda as an instrument of peace and dismantling monopolies which had great control over the economy and the political system. President Ramos succeeded in arranging a political settlement with right-wing rebel soldiers and the Moro National Liberation Front (MNLF). Moreover, the political and economic reforms had virtually reduced cronyism to a minimum.

The Estrada administration has been announcing the same basic line. His cabinet is a mixed bag of rightists, centrists and leftists including former rebels and political detainees. The President is determined to complete the peace process by reaching a political settlement with the communist-led National Democratic Front (NDF) and the separatist Moro Islamic Liberation Front (MILF). However, recent events have raised fears that cronyism is back again, which could undermine both political and economic stability of the country. The personalities that were highly favored during the Marcos regime are now back on the reins of major corporations in the country. Most of them are close friends and strong backers of the President in the past presidential election.

Notwithstanding these new developments, the damage done by the cronies during the Marcos regime on the political and economic stability of the country will not likely be repeated for some reasons. First, most of the economic and political reforms cannot be easily dismantled because of the presence of strong independent bodies, such as the legislature and the judicial institution, which were absent during the Marcos regime. It is to be noted that most of the major reforms were done through legal actions, which cannot be easily undone. Second, there is now a very independent and active press, which has been effectively playing its role as the watchdog and mouthpiece of the general public. And lastly, there is now greater and fairer competition both in the domestic economy and politics.

9. Overall Evaluation

Most recently, the domestic economy, in general, and the financial market, in particular, has started to stabilize. Interest rate has been coming down in the last six months and inflation has been tamed. Although unemployment has risen lately, this is not expected to continue for long since the economy is expected to be grow in 1999, albeit at a modest rate, and in subsequent years.

The return to economic stability can be attributed to a combination of external and internal factors. Regarding external factors, the regional crisis seems to have subsided in the last few months and a run on the currencies of most Asian countries similar in magnitude to the second half of 1997 is unlikely to occur. Also, the Japanese currency has regained its strength vis-à-vis the US dollar, relieving some pressure on the currencies of Asian countries.

Internally, the measures adopted by the government in the past to restructure the economy and strengthen the financial system and most recently in response to the regional crisis have cushioned the impact of such crisis on the domestic economy. Unlike the crisis experienced by the country in the mid-1980s, this time the country has a much larger export sector which continued to grow during the regional crisis period partly offsetting the decline in output of other sectors of the economy. Indeed, the firm resolve of the government to continue with the trade liberalization program and not to impose capital controls despite calls from various quarters sends a clear signal to all market players that economic restructuring as envisioned by the government before the regional crisis struck the country will proceed.

As the regional crisis seeped into the domestic banking system, the central bank saw the need for introducing additional prudential measures to maintain the safety and soundness of banks. These measures will certainly produce a much healthier and sounder banking system. However, there are prudential issues that need to be addressed further. For one, the Philippines has yet to adopt the Basle risk-based capital standards. Second, the disclosure requirement should be extended to all banks, not only to listed commercial banks, to enhance market discipline. Third, some unusual features of the Philippine regulatory system, such as the secrecy of bank deposits and examiner legal liability, should be reduced, if not completely eliminated.

The social compact between management and labor that was facilitated by the government seems to be holding well and has avoided unnecessary economic and social costs on both parties. In interviews with a number of firms conducted for this study, several respondent firms adversely affected by the drop in the demand for their products said that they resorted to reducing the number of working days rather than to laying-off workers.

Although it came after losing a significant amount of its reserves, the central bank's decision to float the peso in July 1997 was certainly the right response to the run on the currency. However, the non-deliverable forward facility developed by the central bank to relieve pressure on the spot market needs to be reviewed because it could be rendered ineffective in the face of massive run on the peso and lead to huge losses that eventually have to be monetized.

The initial monetary and fiscal policy response to the regional crisis was a bit controversial. During the first few days of the crisis, the central bank raised the interest rate to defend the peso. The interest rate was maintained at high levels for quite some time to discourage speculative attack on the domestic currency. It cannot be denied that the high interest rate policy adversely affected the real sector including the export sector, which contaminated the financial sector. While the budget cut enabled the government to put the fiscal position under control, uniformly applying it to all sectors was ill-advised. The social sectors should have been spared from such budget cut at the outset.

The easing of the monetary policy in recent months and the restoration of the budget cuts on basic health and social services programs are steps in the right direction. Presently, the interest rate has already reached its pre-crisis level. While lower interest rate is a necessary condition for relieving the debt service burden of several enterprises, a more

important condition is for demand for goods to rebound. Given that the private sector demand has remained sluggish, the decision of the government to pump-prime the economy towards the second half of 1998 was an appropriate response. Securing external funds to finance the pump-priming activities of the government helped relieve pressure on the domestic interest rate. However, the government needs to carefully manage the country's external debt to avoid repeating the balance of payments problem experienced in the mid-1980s.

IV. FUTURE DIRECTION OF THE ECONOMIC RECOVERY AND DEVELOPMENT

1. Short-term

More than a year after the Asian currency crisis struck, there still remains some uncertainty as to whether the economy can quickly recover. Although both the government and the private sector are forecasting a GDP growth rate of more than 1.5 percent for 1999, still there are downside risks. A second round of sharp currency depreciation could occur if the Japanese economy continues to slide down, putting pressure on the Chinese currency, and if the situation in Russia and some Latin American countries deteriorate further. Because of the slowdown in global growth, continuing uncertain investment environment in emerging markets, and previous volatility that has made investors more risk-averse, financial flows to the Philippines are not expected to recover to their historical highs in the 1990s in the very short-run.

The decline in the domestic interest rate in the last few months has significantly reduced indebtedness of the corporate sector. Non-performing loans of banks are then expected to decline, obviating the need for large resources to recapitalize the banking system. Nonetheless, despite the recent decline in the interest rate, there are still no indications that bank credit will start growing again even at moderate rate. This can be attributed to the continuing fears of recession and the possibility of a second round of currency instability in the Asian region.

The export sector, which has been performing exceptionally well during the crisis, is recently threatened by the recent appreciation of the domestic currency. Meanwhile, the corporate sector has been increasingly underutilizing their capacity as they continue to slow down their production activities and run down their inventories. The expected rebound of the agricultural sector in 1999 may not be sufficient to offset the potential decline in both the industrial and services sectors if current trends are going to continue.

There are, however, positive signs that can create a favorable environment for economic recovery for the Philippines. First, the decline in the interest rate in the US has eased concerns for a global liquidity crunch. The additional benefit to the Philippines is that it will partially ease the external debt burden of the country and, at the same time, support the continued decline in the domestic interest rate. Second, the passage of a series of measures made by the Japanese parliament recently to address the ailing Japanese economy, in general, and the banking sector, in particular, has significantly abated fears of a Japanese meltdown. Third, the agricultural sector will be given a reprieve from the bad weather next year as El Nino fades away.

These positive developments could be exploited to restore confidence in the domestic economy and spur economic recovery in the short run. Aggregate demand must be pushed upward through a combination of expansionary monetary and fiscal policies. Interestingly,

the recent decline in the domestic interest rate did not create pressure on the exchange rate, suggesting that there is some scope for a looser monetary policy. The large pool of unemployed people, underutilized capacity of the corporate sector and low commodity prices in the international markets can help cushion the impact of an upward shift in aggregate demand on domestic prices.

More than ever, the export sector needs to be supported. The BSP must prevent further appreciation of the peso to maintain the competitiveness of the export sector of the Philippine economy. It may start purchasing dollars to re-build its reserves, bring it to a comfortable level and avoid using it to defend the peso. This requires the maintenance of a flexible exchange rate policy. The resulting increase in domestic liquidity must not be sterilized to support a low domestic interest rate.

The government has programmed a P17.9 billion deficit for 1999. This may not be enough to support a much needed increase in aggregate demand. It must, therefore, allow a much higher fiscal deficit for 1999, possibly bringing forward to 1999 the P9 billion the IMF is willing to add to the P40 billion deficit the government has programmed for 1998.

This expansionary policy can easily reverse the currently positive current account position of the country. Since private capital flows are expected to remain weak in the short run, the growing current account deficit resulting from the expansionary policy could create huge pressure on the exchange rate, possibly causing more currency instability that could undermine the recovery efforts. To forestall the occurrence of such situation in the economy, the financing gap must be filled up by official flows.

Imports for the agriculture sector are expected to rise partly as a result of the newly passed Agriculture and Fisheries Modernization Act. The agricultural growth will have beneficial economic and social impacts as most of the poor reside in rural, agricultural areas. The government, therefore, has to secure additional ODA for balance of payments support to finance the gap.

The higher budget deficit could exert pressure on the domestic interest rate and crowd out the private sector if much of it is financed by borrowing from the domestic market. The government can avoid such situation if it can secure more ODA for budget support. It must also continue its program of lengthening the maturity of its debt instruments to reduce volatility in the domestic interest rate whenever it goes to the market to borrow.

The additional government expenditure can be directed to the social sector to make up for the effects of the budget cuts on them in the past and to make up for the past backlogs, such as construction of classrooms. Aside from the education and health sectors, housing also needs a boost.

The sharp slowdown in bank credit in the last few months has severely affected SMEs' access to the credit market. Part of the additional government expenditure could be used to beef up resources of government banks for on-lending to the SMEs, which could lead the way for the private banks to open their lending windows again to SMEs.

The relatively low NPLs of the banking system can allow banks to quickly resume lending to the private sector. However, as the banking sector resumes their lending to the various sectors of the economy, there is need for improving prudential regulations for and effective surveillance of banks to maintain their financial health and avoid the mistakes in the past. This calls for the immediate reform of the laws and regulations covering entry and operations of banks.

Merger, consolidation and acquisition will become more intense in the banking system in the next few months as banks try to strengthen their capital base. The BSP could take a more pro-active stance to make merger, consolidation and acquisition happen smoothly and as quickly as possible. This issue, together with the further liberalization of the banking system to allow foreign banks greater participation in the domestic banking system, could be addressed in the revision of the general banking act.

Some corporations have already learned to raise long-term funds from the capital market. Others are waiting for the right time to raise long-term funds from the capital market. Some investors have already learned how to invest their money in the capital market. However, more investors could have placed their excess funds in the capital market if they only have stronger confidence in the market. This, therefore, calls for the reform of the securities act to boost investors' confidence in the capital market. This should be accompanied by reforms in the mutual fund system to raise more long-term funds and, at the same time, give small savers greater access to the capital market.

2. Medium- and Long-term

Monitoring of Capital Flows

While the government continues its policy of allowing a free flow of capital, it should, however, continuously monitor the capital flows, particularly, short-term capital because these flows are highly dependent on changes in the sentiments or market perceptions of foreign lenders or investors. Nowhere is this problem more clearly demonstrated than in the differences in the report prepared by the World Bank and the BIS on short-term foreign liabilities of the Philippines. In 1996, for instance, the World Bank reported that short-term liabilities of the Philippines constituted 19.3 percent of its total foreign liabilities, while the BIS reported 58 percent. An information on the external liabilities of the Philippines that truly reflects real conditions can greatly help policy makers and the private sector make informed decisions and avoid sudden changes in the sentiments or perceptions of the market, which eventually get reflected in the volatility in the exchange rate and the domestic interest rate.

Once the domestic and international markets have stabilized and better prudential regulations for banks are put in place, the government should continue the liberalization of the capital account of the balance of payments.

Fiscal Management

The economic recovery can only be sustained in the long-run if the government manages well its finances. This only serves to underline the need to improve the government's revenue effort, which needs a two-pronged approach: improvement in tax administration and further tax reforms.

Improvement in tax administration can yield high pay-off for the government. In 1996 alone, Manasan (1998) estimated that uncollected revenue from the individual income tax amounted to P48.5 billion, which is equal to 13.2 percent of the national government tax revenue for the same year and 2.1 percent of GNP. The level of corporate income tax evasion for the same year reached P43 billion, which is equivalent to 11.7 percent of national government tax revenue or 1.7 percent of GNP. As regards the VAT, the level of VAT evasion hovered about P79.7 billion in 1996, which is equivalent to 21.6 percent of national government taxes or 3.4 percent of GNP. The recently instituted Comprehensive Tax Reform Program (CTRP) cannot make a substantial difference unless tax administrative is considerably improved.

The above-mentioned CTRP has left out a number of items that could improve further the government's revenues. One of the most important items is the rationalization of fiscal incentives and subsidies. In 1997 alone, the Department of Finance estimated that the various fiscal incentives cost the government about P28 billion. The fiscal incentives should be scaled down and sharply targeted to economic activities that need them most.

The potential revenue yield from these reforms can easily close the budgetary fiscal deficit and provide the government more resources to finance worthwhile activities. In this regard, Manasan (1998) recommended that capital outlays and government expenditures on maintenance and other operating expenditures must be restored to their levels, as a percentage of GNP, prior to the 1984-1985 external debt crisis. The amount can be adjusted to account for the increased involvement of the private sector but it is most likely that only government capital outlays will be affected. The government must put emphasis on maintenance and operating expenditures since the adverse effect of underspending on the upkeep of infrastructure is cumulative and manifests itself mostly in the medium term, creating severe disruptions and damage to the economy.

Capital Market Development

To support the development of the capital market, taxation of the financial sector to minimize distortions and transaction costs must also be reformed. The two important taxes are the documentary stamp tax (DST) and the gross receipts tax (GRT). The cascading effect of DST on highly traded financial instruments has reduced the attractiveness of these instruments, thereby undermining the development of the securities market. The GRT, on the other hand, tends to raise the cost of credit.

Since the abolition or reduction of DST and GRT rates can have large implications on government revenues, the reform on these taxes should be done in tandem with the above-

mentioned tax and tax administration reforms so as not to blow up the government deficit during the recovery period.

Industrial Restructuring

The decision of the Estrada administration to push through with the policy of moving towards a uniform tariff rate by 2004 can lead to more restructuring of the industrial sector and improvement in microeconomic efficiency. The sharp depreciation of the peso provides enough time for the domestic-oriented industries to make the necessary adjustment in order to survive in a more competitive environment. Improvement in productivity will be a key factor for the survival of these industries.

Technology and Human Resource Development

This area should focus on bridging the dichotomy between the export sector and the domestic manufacturing sector. The key is the development of technological capability. While technology transfer is important, this is not possible without the appropriate level of human capital.

There are four key areas for policy reform: a) technology transfer mechanisms must be made more effective; b) R&D effort must be more focused and integrated; c) human resource development must be oriented to improve factor productivity; and d) the functions of the Department of Science and Technology must be streamlined.

Technology transfer mechanisms

Government must first set clear strategies for technology development--whether adoption, modification, or generation--by industry. This recommendation hints of industrial policy but given that technology does not have the standard characteristics of a commodity (in economic jargon, it is "nontradable") government intervention may be justified. Government intervention can be effective if carefully designed, sparingly granted, strictly monitored, and offset by measures to force firms to aim for world standards of efficiency. Four advanced technology areas for aggressive supply push strategies have been identified: microelectronics, materials science, information technology, and genetic engineering.

The private sector must be encouraged to practice "mirroring" in their ventures with multinational corporations. As explained in other studies, regardless of the initial arrangement of technology transfer, the Koreans instituted incremental changes to absorb the technology, like replacing foreign personnel with local people, substituting local engineering for foreign engineering, doing forward and backward integration, and others. Similarly, multinational corporation-local enterprise technology transfer programs, similar to what Singapore and Malaysia, did must be encouraged.

R&D Effort

R&D capability must be enhanced to eventually achieve technological self-reliance. The linkages among the government, private sector, and academe must not only be strengthened along specific technological programs but at the same time, their roles must be clearly delineated. For example, the responsibility for developing advanced technologies will rest primarily with the public sector. There should also be investment in industry-linked R&D institutions and university-linked basic research in selected areas.

For this to succeed, there should be greater investment in R&D. This can be achieved through larger government appropriations for this purpose. Private investment in R&D can be encouraged with greater competition, by strengthening laws related to patents and intellectual property rights (IPR) and by implementing incentives (e.g., tax breaks) to increase fund allocation toward R&D.

Finally, institutional gaps that weaken the linkage among technology generation, adaptation and use must be addressed. For example, the government can support pilot testing of inventions to determine their commercial and technical feasibility.

Human Resource Development

A well educated labor force is the *sine qua non* of technological development. The government can start with the basics by strengthening education in the primary and secondary levels. The proposal made by some experts to teach mathematics and science in the regional language during the elementary phase to ensure that basic concepts are well assimilated must be considered seriously.

At the level of tertiary education, government support to science, engineering and other laboratory intensive courses must be emphasized. To remedy the incentive system, salaries of professors in centers of excellence must be exempted from the salary standardization law but at the same time, a strict accreditation system for the faculty must be instated.

The country should train its manpower for the higher stages of production activities not only to prime qualified skilled workers to work in developed countries but also to prepare them for future shifts toward higher skill-intensive domestic production activities. This should complement the rising labor costs relative to countries like Indonesia, China and Pakistan. This can be supported by government and private sector investments in industry-linked polytechnics and HRD programs.

Infrastructure

Infrastructure development has been described as the weak link in the economic chain in the Philippines. During the 1980s, the expansion of infrastructure in the Philippines lagged behind other Asian countries in terms of paved roads, electricity generation capacity, electricity production, telephone main lines, railroad tracks, and access to sanitation.

Privatization, deregulation, and liberalization of the various infrastructure sectors were recently undertaken to spur development. Overall, the outcomes of the sectoral reforms have been beneficial in terms of increased supply, lower water rates, and better quality of service. Reforms should continue, particularly in areas where the presence of the government is still large and is not producing desirable results in terms of quality of service and revenue to the government. For instance, the government-owned National Power Corporation which continues to lose money heavily needs to be privatized. Other issues in the power sector, such as pricing and consolidation of the various regulatory functions into a single agency, need to be studied. The experience in Metro Manila with the transfer of responsibility for water supply and sanitation from the government to the private sector has to be examined carefully so that a similar, if not better, scheme can be promoted in other cities of the country.

Rural infrastructure projects, such as small irrigation systems, farm-to-market roads, drinking water supply system, etc., must be given top priority by the government in its budget and/or development assistance program.

There are also other issues in the infrastructure sector that must be addressed by the government. These include, among others, the creation of a competitive environment in the infrastructure sector, equipping the agencies with the necessary capacities to deal effectively with the demands of a market-oriented policy regime, organizing lead agencies in a manner that facilitates coordination and strategic planning, exercising prudence in assuming contingent liabilities, and properly delineating national-local government roles.

Agriculture Sector

The primary focus in this area should be the restructuring of agriculture tariffs. The recent devaluation of the peso presents an opportunity to correct the high protection rates of major commodities such as rice, corn, sugar, livestock and poultry and other minor crops. At the same time, a market-based approach, i.e., auctioning, must replace the current system of in-quota imports of these commodities, as specified by the minimum access volumes, to transfer to the general public the rents received by quota holder.

Aside from increased public expenditures for agriculture, more efficient allocation within agriculture and streamlining of the bureaucracy are required to strengthen support services to agriculture. A greater proportion of the budgetary allocation for agriculture must be spent for productivity-enhancing investments, especially agricultural research, development and extension, market infrastructure, and irrigation support. The institutional reforms should aimed at facilitating the streamlining and strengthening of coordination

between local and central governments in delivering better quality support services to the sector.

V. ACTION PLANS

This section outlines specific action plans that the government ought to adopt to stage a rapid economic recovery in the short-run and a sustainable growth in the long-run. Although some of these action plans may not be new to or are currently being contemplated by the government, nevertheless they are discussed here to emphasize their importance in resuscitating the economy.

The action plans are grouped into two categories: short-term and medium- to long-term. Action plans in the short-term are those that the government must immediately initiate and complete within two years. These are essentially confidence-building measures to spur economic growth in the short-run. It is to be noted, however, that some of these actions have very specific purposes and have short-run impacts on the economy, while others have long-run impacts.

Action plans falling under the medium- to long-term category include those that the government ought to immediately initiate, although they may not necessarily be completed in two years time and/or those that can only be done after completing some prior actions. These actions are aimed at restructuring the economy or specific sectors of the economy and, therefore, they have implications on the long-run sustainability of the economic growth that is expected to occur in the short-run.

The specific instruments, which the government could use to make the necessary actions, can either be legislative or administrative action or both. Legislative process in the Philippines usually takes a long time. However, if the Executive and Legislative branches of the government come to agree on a set of urgent measures, the Legislature, as is done in the past, can give these measures high priority and utmost attention in its legislative agenda.

Finally, the primary government agency(ies) that will be involved in initiating the proposed action plans are identified.

1. Short-term

a. **Pump-Priming Measures**

The government should continue its pump-priming activities well into 1999. However, the government proposed budget for 1999, which will likely be passed by Congress either late in December 1998 or early January 1999 does not clearly reflect this program. There is, therefore, a need to request Congress for a supplemental budget in the first quarter of 1999 so that the pump-priming activities of the government can all be completed within one year. The pump-priming measures should focus on the critical sectors of the economy, specifically agriculture, which has the most extensive linkages with the rest of the economy, thus generating the highest multiplier effect; SMEs, because of their insufficient access to formal credit and modern technology and the fact that they are going to be the shock absorbers for those who are going to be negatively affected by corporate restructuring; and social sectors, because the poor do not have the resources to protect

themselves against the adverse effects of the economic crisis and because of their long-term impact on productivity.

Agriculture Sector

The devastating effects of El Nino and the threat posed by La Nina on the agricultural sector should have already convinced the government of the need for directly confronting these problems by accelerating the provision of the much-needed infrastructure for the agricultural sector, such as irrigation, post-harvest facilities, farm-to-market roads, etc. Unfortunately, however, the President's proposed budget for the agricultural sector for 1999 in nominal terms is even lower than the 1998 general appropriations act, and in real terms even lower than the 1997 level. It is to be noted that the government expenditure on irrigation has been declining in real terms over the years, making it difficult to maintain existing ones and doubly difficult to construct new ones to make up for the backlogs built over a number years of neglect. The Mindanao regions, which have long been neglected by the government in terms of infrastructure programs and were hardest hit by the El Nino, must be given utmost priority in allocating additional budget.

Between capital outlay and maintenance and other operating expenses (MOOE) for the irrigation system, the latter must be given higher allocation from any additional budget to restore the efficiency of existing irrigation systems to their original levels. The Department of Agriculture should identify the irrigation facilities that need to be rehabilitated and prioritize them. Together with the Department of Public Works and Highways, it must also identify agricultural farms that need new irrigation facilities and prioritize them.

Required action:	Legislative
Lead Agencies:	Department of Agriculture
	Department of Public Works and Highways
	National Economic and Development
	Authority
	Department of Budget and Management
	Congress

Social Services Sector

The President's proposed 1999 budget for the education and health sectors will be lower in real terms than their corresponding 1997 and 1998 budgets. This has immediate implications on the poor people's access to basic services, especially those who are temporarily laid off because of the ongoing crisis. This will also have a negative impact on human development and labor productivity in the long-run, which will undermine the country's competitiveness.

For the health sector, priority should be given to increasing the budget for MOOE. Also, timely releases of these funds are important. As regards education, both MOOE and capital outlay must be increased significantly. However, in the case of capital outlay, priority

must be given to areas of the country that need them most. The Department of Education can easily identify these areas.

The housing sector is another sector that must be given additional attention by the government especially since it has both direct economic impacts in the short-run. Although the President's 1999 budget for this sector is going to be increased in real terms relative to 1998, still it falls far below the levels in the 1980s, making it hard to fill up a sizeable proportion of the existing housing backlogs. A substantial part of the increase in the budget allocation for the housing sector must be used for the following activities:

- (1) To build-up the resources for the one-time capital grant. The one-time capital grant is proposed by Llanto, Orbeta, Sanchez and Tang (1998) as an alternative subsidy scheme that will not distort the housing credit markets, will provide better incentives for private sector participation, especially the banks, and is transparent to the public and policy makers;
- (2) To transform the National Home Mortgage Finance Corporation (NHMFC) into an institution mainly active in secondary mortgage and provide new resources for it. NHMFC can play a big role in the development of asset-backed securities; and
- (3) To beef up the resources of the Home Insurance Guarantee Corp. (HIGC) so that it will have enough resources to provide guarantees to bonds to be issued by local government units (LGUs) for the purpose of financing mass housing projects in their respective localities.

Required action: Legislative

Agencies involved:

For the health sector –

Department of Health

National Economic and Development

Authority

Department of Budget and Management

Congress

For the education sector -

Department of Education and Sports

National Economic and Development Authority

Department of Budget and Management

Congress

For the housing sector –

Department of Finance

Housing and Urban Development Coordinating Council

National Home Mortgage Finance Corporation

Home Insurance Guarantee Corp.

National Economic and Development Authority

Department of Budget and Management

Congress

Credit Programs

The rise in the non-performing loans (NPLs) of banks in recent months has constrained banks from aggressively lending to the sectors they normally serve. The deceleration in the flow of credit is also affected by the slowdown of the economy because it has adversely affected banks' efforts to mobilize deposits. Worst affected among banks are the thrift banks and rural banks, which cater to SMEs and the agriculture sector. Also, rural banks were hardest hit by the sharp contraction of the agriculture sector in 1998 caused by El Nino. Other than deposits and re-lending windows of government financial institutions, thrift banks' alternative source of funds is the commercial banks. However, this source of funds has dried up due to high cost of funds and the cautious attitude adopted by commercial banks during the crisis.

The government has been given attention to the SMEs' and agriculture sector's credit needs as can be gathered from a number of special credit programs created for these sectors. However, most of these credit programs, especially those that are administered by nonfinancial government agencies, have been found ineffective and inefficient (Lamberte et al., 1997 and 1998).

All this suggests that SMEs' and the agriculture sector's access to credit will likely be impaired in the next two years – a situation that will drag down the economic recovery efforts. To address the liquidity problem faced by SMEs and the agriculture sector, two actions are proposed to the government. First, the various credit programs of the government to SMEs and the agriculture sector must be rationalized to improve their effectiveness and efficiency. Second, resources of the government financial institutions (GFIs), specifically the Development Bank of the Philippines (DBP) and Land Bank of the Philippines (LBP) for SMEs and the agriculture sector must be beefed up to provide liquidity to these sectors. Private banks that want to resume or increase their credit to SMEs and the agriculture sector could tap the wholesale windows of these GFIs.

Required action:	Legislative and administrative
Agencies involved:	Department of Finance
	Department of Trade and Industry
	Department of Agriculture
	Development Bank of the Philippines
	Land Bank of the Philippines

b. Resource Mobilization Measures

Renegotiating the Short-term Bridge Financing Loan

The government must try to renegotiate the one-year US\$610 million bridge financing it obtained from domestic banks' FCDUs a few months ago for a much longer

period, say three or five years, so that it can save the resources for its pump-priming activities for 1999.

Required action: Administrative
Agency involved: Department of Finance

Privatization

Due to the cyclical downturn of the economy, government tax revenues are likely to decline during the crisis period. On the other hand, the rebound in tax revenues will not immediately happen when the economy starts to recover due to lag effects. It suggests that the government must look for other sources of raising resources in the short-run to fund its pump-priming activities. Privatization can be a good candidate.

There are still a number of so-called “big ticket items” that can be privatized to substantially increase the nontax revenues of the government in the next two years and partly make up for the cyclical decline in tax revenues. Examples are: the remaining government’s shares in PNB and Petron, Food Terminal Inc. (FTI), Philippine National Oil Corporation’ subsidiary – Energy Development Corporation, and National Power Corporation (NPC).

If needed, the legal instrument for the privatization of these “big ticket” items should be completed within one year so that privatization can proceed. For example, the Omnibus Bills on the Electric Power Industry must be passed in 1999. The final draft should take into account the objective of increasing the efficiency of this industry by establishing a level playing field for all players.

Required action: Administrative and Legislative
Agencies involved: Department of Finance
Government corporations concerned

Financial Sector Reforms

The financial sector must continue to improve its effectiveness and efficiency in mobilizing and allocating funds to meet the growing demands of the economy, especially the new challenges posed by the recent trend towards globalization and greater international integration of financial markets. The antiquated legal frameworks governing the banking system and the capital market in the Philippines must be overhauled to modernize the domestic financial system, raise confidence of depositors and/or investors, both local and foreign, in the financial system and facilitate the mobilization and allocation of savings.

Banking Sector

The General Banking Act was formulated in the late 1940s and slightly amended in the 1970s and 1980s. Since then, the financial sector environment has changed a lot, exposing banks to greater competition and new types of risk. This is compounded by the freer flow of capital, which were mostly intermediated by the banking system. Indeed, the

large swings in capital flows experienced in recent years by the Philippines underline the close relationship between the degree of stability of the economy and safety and soundness of the banking system.

The General Banking Act must, therefore, be radically changed to take into account the ability of financial institutions to create a wide variety of financial instruments, bring the prudential regulations of the Philippines up to the internationally accepted prudential standards, adopt modern approaches to bank supervision, strengthen disclosure rules to make banks more transparent to the public, among others. The repeal or substantial amendment to the deposit secrecy act must be made to strengthen the effectiveness of bank supervision and examination and reduce insider abuse, which has been the major cause of many bank failures in the past.

Required action:	Legislative
Agencies involved:	Congress
	Bangko Sentral ng Pilipinas
	Department of Finance

Capital Market

Despite the boom in the securities market recently experienced by the Philippines up until the Asian currency crisis struck, still the resources raised by the capital market fell far below its potential due to inefficiencies of and lack of confidence of the public in the market. Increasing the confidence of the general public in this market can be partly addressed by having an effective regulatory framework. Unfortunately, however, the present legal framework cannot respond to this need and also does not measure up to the challenges posed by a fast evolving capital market that is becoming closely integrated with the rest of the world.

The existing securities act, therefore, should be amended to develop a more orderly, transparent and effective capital market that can inspire confidence of the investors. Modern approaches to securities development, such as shifting from merit regulation policy to full disclosure, allowing securities association to become self-regulatory organizations, separation of broker-dealer roles, improved protection of minority shareholders, tighter provisions on insider trading, etc., must be expressly incorporated in the new law. Also, the regulatory body, i.e., the Securities and Exchange Commission (SEC), must be reorganized so that it can have greater flexibility to respond to the requirements for effective supervision and regulation of a fast evolving capital market.

The mutual fund industry, which can be a good investment vehicle in the capital market for small savers, has been lagging behind those of other countries in the region. One of the reasons for this is the antiquated, control-oriented legal framework, which was framed more than 35 years ago to address the collapse of some mutual funds. For example, it does not give mutual fund managers sufficient flexibility in the determination of investment objectives. Also, the stringent seed capital requirement discourages the registration of

mutual funds with multiple investment objectives. The Investment Company Act, which is the operating legal framework for the mutual fund industry, must, therefore, be amended.

Required action:	Legislative
Agencies involved:	Congress Department of Finance Securities and Exchange Commission

Bond Issuance

Issuing government bonds in the international private capital market is one way of quickly mobilizing resources. In fact, the government has already drafted a concrete plan on this. However, the government must resort to this only if the premium placed by international investors on emerging market issues has returned to normal levels.

Required action:	Administrative
Agencies involved:	Department of Finance Bangko Sentral ng Pilipinas

2. Medium and Long-term

a. Monetary, Banking and Exchange Rate Policies

Monetary and exchange rate policies should aim at providing an environment that is conducive to a wholesome economic growth. Since July 1997, the BSP is committed to a flexible exchange rate. This policy should be maintained, and the signals the BSP gives to the market must be consistent with this policy. The conduct of monetary policy, on the other hand, needs to be reviewed in light of the rapid financial innovations that has been going on since the liberalization of the banking sector and foreign exchange market. Although the BSP has started doing this recently, however, it must intensify its efforts so as to maintain the effectiveness of its monetary policy.

Given the fact that a major economic crises including the present one struck the Philippines almost every seven years, it is indeed worthwhile to develop an early warning system for balance of payments and financial crises similar to the one developed by Yap (1998). Such early warning system could be made part of a wider system of monitoring and surveillance of the economy.

In view of the increasing financial market integration, the BSP must improve its information system on capital flows, especially short-term capital flows which are highly volatile and are largely intermediated through the banking system. Also, given the contribution of increasing corporate debt to the present crisis, the BSP must include in its monitoring system the level and structure of corporate debt.

To complement the proposed legal reforms for the banking system, the BSP needs to upgrade its capability to supervise and examine banks which are operating in a more liberalized regime.

Required action:	Administrative
Agency involved:	Bangko Sentral ng Pilipinas (BSP)

b. Competition Policy Framework

To be resilient and full of dynamism especially with the current trend towards globalization, the economy must have a competitive market structure. The government should work towards accomplishing this goal by developing a coherent national competition policy framework. As already demonstrated here and elsewhere, liberalization alone does not necessarily lead to effective competition. It requires a good antitrust law and an agency capable of enforcing laws and regulations on competition. Unfortunately, the current legal, regulatory and institutional framework for competition is highly diffused and weak in preventing anti-competitive behavior. The trend towards bigness achieved through merger, consolidation or acquisition needs to be watched closely so that no dominant player can set up anti-competitive barriers. Recent events, such as the alliance made by three dominant shipping companies and the acquisition by a dominant player in the cellular phone sub-sector of a dominant player in the telephone sub-sector, have left the general public wondering whether liberalization without any effective regulations to make markets competitive will ever yield beneficial results in terms of excellent and prompt services at prices affordable to a great majority of the population.

Required action:	Legislative
Agencies involved:	Congress National Economic and Development Authority Department of Trade and Industry Department of Transportation and Communications Department of Justice Department of Agriculture Bangko Sentral ng Pilipinas

c. Establishing Competitive Infrastructure Sectors¹¹

The infrastructure system in the Philippines is inadequate and highly inefficient, which raises the cost of doing business in the country and lessens the competitiveness of the economy as a whole. Sachs *et al.* (1998) have proposed increased private participation in the infrastructure sectors (i.e, electric power, telecommunications, water supply and wastewater, and transport) as a way of meeting the demands for infrastructure and of improving their efficiency. However, this requires legal and regulatory framework to support competitive

¹¹ This complements the discussion in the previous section.

infrastructure sectors. Policy-induced barriers to entry must be identified and dismantled. For example, it takes a long time to obtain a public utility license from the legislative and executive branches of the government. The dual role played by the government (i.e., as a regulator and an operator) in infrastructure sectors as in the case of the ports subsector discourages private sector participation.

Regulations that tend to distort the market must be changed. For example, the tariff setting based on rate-of-return method gives utility firms incentives to over-invest, inflate costs and engage in cross-subsidization.

Aside from a good legal and regulatory framework for increased private sector participation in the infrastructure sectors, the technical capabilities of regulatory agencies must be strengthened to deal effectively with the complex demands of a market-oriented policy regime (Serafica 1998).

Required action:	Legislative and administrative
Agencies involved:	Congress Department of Transport and Communications and attached agencies Department of Justice

d. Improved Tax Revenue

As regards improving tax administration, Manasan (1998) provides the following measures:

Improved Monitoring of Stopfilers. Available data show that only 78 percent of all VAT registrants filed returns in 1994. While no comparable figures are available for other types of taxes, key informant interviews suggest that this is a problem that is common to all types of taxes. The importance of and the inadequacy of the present system of monitoring stopfilers is exemplified by this little story on how the recent and highly-publicized tax diversion scam was uncovered. Apparently, the scam was first noted when one Regional Development Office (RDO) which has a functioning manual taxpayer monitoring system in place noticed that some taxpayers have failed to pay their taxes. After follow-up calls were made on said taxpayers, the RDO was informed that the taxpayers already paid their taxes. And the rest is history. However, it is worth noting that the large amount involved in the scam indicate that it took a while before it was discovered. This implies that many RDOs have weak monitoring systems in place.

To enhance monitoring of stopfilers, it is critical for the BIR to have a taxpayer masterlist. The absence of such a list has been a persistent problem to date. The full implementation of the BIR computerization program (or the integrated tax system) in 1999 is expected to address this lack. However, the installation and use of manual systems in the meantime is imperative. Also, under the computerized regime, it is important that the RDOs learn how to use the system properly so that they can fully maximize its capabilities. Initial reports in the pilot roll-out areas show that some RDOs resort to requesting the Data Center

to print out the list of stopfilers and generate reminder letter even if the system allows them to do these tasks themselves.

Installation of Selective Audit Policy and Procedures. In principle, the objective of tax audits is not so much to increase enforce enforcement revenue as to improve voluntary compliance. The BIR's audit function is not only central to its effectiveness as an institution but also key to the poor public image of the BIR.

Within the BIR, the audit function is subject of great debate and some ambivalence even amongst its key officials. On the one hand, many revenue officers requests authority to examine all tax returns even if it is beyond their ability to complete, much less outside their capability to subject to quality audit. At the same time, while some taxpayers have not been examined at all, others have been subject to annual tax audits despite high tax compliance. This has led to the widespread perception that tax audits are being used to systematically harass many taxpayers.

On the other hand, some key officials, from time to time, have tended to disregard this tool. Thus, one hears of protracted periods during which the issuance of Letter of Authority (for the conduct of audit) was suspended. While the BIR officially supports a program of selective audit, there appears to be some inconsistency between policy pronouncement and actual practice. For instance, Revenue Memorandum 26-94 prioritizes the audit of large taxpayers. "This not only prejudices said large taxpayers but also sends the wrong signal about being big and successful."

The experience in countries with modern tax administration tends to show that tax audit is not an all or nothing proposition. In fact, it is the opposite. One of the principal ingredients to enhancing the effectiveness of tax audits is the implementation of a selective audit program. The key to said programs is a means of selecting taxpayers who are shown to have the highest probability of under-reporting their tax liability. Usually this is aided through the use of statistical analysis. The computerized BIR tax system when it is fully implemented is expected to have this capability. However, it is one thing to know that there are provisions in the integrated tax system for the incorporation of a selective audit program, it is another thing to find out "whether the selection system fulfills the requirements of the Bureau before it becomes operational" (TAAP Memorandum May 30, 1997).

Third Party Information (TPI). Evasion estimates of the income tax tend to show that the bulk of the problem stems from under-reporting of receipts/income. Third Party Information is one way of addressing this issue.

Initial efforts to collect and analyze Third Party Information have focused on oil/gas dealers. This work has been well-received by BIR officials. It has also generated interest in extending its application to other sectors.

There has been some disagreement, however, on whether the TPI should be used to assess additional taxes through the issuance of LAs or whether concerned taxpayers should simply encouraged to file amended returns. There has been some apprehensions that the

first approach will may lead to the harassment of taxpayers. In either case, it is important that a good internal control system be put in place to keep track of how data gathered from the TPI are used and to ensure that the same are not used to harass taxpayers. Also, it is important that data generated from the TPI be used to develop audit procedures and techniques, standards and norms specific to the concerned sectors/industries.

Improved Performance Evaluation System for Revenue Officers. There is a general agreement that one of the most serious problems facing the BIR has to do with its personnel. For one, the public image of the BIR is one of inefficiency, if not corruption. Coupled with the low pay scale, this has resulted in the low morale of BIR personnel.

To deal with this problem, it is important that an appropriate performance evaluation system for revenue officers be developed and put in place. It is essential that good performance is rewarded in the same manner that bad performance is sanctioned. In this regard, it is noted that while the re-shuffling of revenue officers once every 3 years might be justified on the ground that it discourages special arrangements/relationships between revenue officers and taxpayers, the current practice of re-assigning revenue officers to far-away posts as “a disciplinary device only transfers inefficiencies from one place to another in the revenue service.”

Training Front Line Personnel to Prepare Them for Computerized Regime. The on-going computerization program of the BIR has been vested with great expectations. It has been pointed out that “automated systems do not collect taxes, they only provide the supporting framework which can maximize the productivity of people.” As such, it is essential that human aspects of the shift towards the more computerized regime be carefully managed.

In this regard, the very first step is to provide computer literacy training to front line personnel. Undeniably, the degree of computerization in the Bureau prior to this change is low. As such, revenue officers view computers and the accompanying system with some trepidation, if not resistance. It is essential that this problem be dealt with immediately even before training on the specifics of the new integrated tax system are conducted.

Creation of Data Centers. The creation of data centers is already proposed in the continuing streamlining effort at the BIR which is under review by the DBM. The Data Centers are important in ensuring timely and consistent data input. They also appear to be at the heart of computerized system's quality assurance system.

Action required:	Legislative and administrative
Agencies involved:	Congress
	National Economic and
	Development Authority
	Department of Trade and Industry
	Department of Finance
	Board of Investments
	Bureau of Internal Revenue

e. Taxes on the Financial Sector

There are three taxes that must be settled. These are: tax treatment of loan loss provisions of banks, documentary stamp tax and the gross receipts tax.

Since the introduction of general loan loss provision and the restructuring of specific loan loss provision which will compel banks to set aside more resources to comply with the new schedule of allowance for probable losses, there appears a lively discussion on the tax deductibility of loan losses. It is to be noted that countries all over the world vary as to the method of tax deduction for loan losses they use. Some use the *charge-off method*, which requires that a debt be uncollectible and written off at the time the tax deduction is claimed, while others use the *provisions method*, which allows the tax deductibility of eligible provisions for bad and doubtful debts without requiring a book write-off of the underlying asset (Escolano 1997). Concerning the latter, the tax-deductible provisions may be *general* (general provisions method) or *specific* (specific provisions method).

A particular design for tax treatment of loan losses can have a strong incentive for prudent or imprudent bank behavior. It can also have a sizeable impact on government revenue. Thus, this issue must be carefully studied before drafting the necessary legislation.

There is now a growing consensus as to the need to abolish the documentary stamp tax (DST) for highly traded financial instruments to support the development of the capital market. However, instead of immediately abolishing the DST, it is suggested that it be gradually reduced from the present level to zero over a four-year period to give the government adequate time to improve tax administration and put other tax measures in place so that the negative revenue impact of the DST abolition can be mitigated. The legislative framework for this measure must be drafted and passed in 1999 so that it can immediately be implemented.

The government must complete its study in 1999 regarding the possible substitute for GRT and its impact on government revenue so that the legislative framework could be passed in 2000 and implemented in 2001.

Required action:	Legislative
Agencies involved:	Congress
	Bangko Sentral ng Pilipinas
	Department of Finance
	Bureau of Internal Revenue

f. Pension Fund System Reform

The pension fund system, particularly the government-sponsored pension funds namely the SSS for private sector employees and GSIS for government employees, needs to be reviewed so that they can become more effective players in the development process. One of the issues that must be addressed is whether the two systems need to merged or maintained

separately but make their benefits portable to promote labor mobility. Enhanced labor mobility is needed to make the economy more resilient. Another issue is the need to improve the yields to the funds of both systems by possibly employing external private fund managers as is done in other countries like Chile. Together with this is the need to liberalize the investment of pension funds in foreign assets to minimize the exposure of pension assets to the Philippines' country-specific risk. This, of course, requires some prudential standards and supervision.

A thorough review, therefore, of the pension fund system must be done in 1999, the results of which can serve as a basis for drafting the necessary legislative framework to reform the system.

Required action:	Administrative and legislative
Agencies involved:	Department of Finance Social Security System (SSS) Government Social Insurance System (GSIS)

g. Industrial Restructuring

The government must remain firm in its decision to maintain the policy of moving towards a uniform 5 percent tariff rate by 2004. The BSP should complement this policy by maintaining a flexible exchange rate policy and preventing any overvaluation of the peso. Hopefully, a more competitive industrial sector will emerge.

To enhance further the competitiveness of the industrial sector, the government must continue addressing the infrastructure bottlenecks (e.g., major highways linking industrial and commercial areas, farm-to-market roads, fishing ports, airports, etc.), which have raised the cost of doing business in the Philippines, through appropriate level of public expenditure in infrastructure and appropriate policies for private sector involvement in infrastructure investment. The government must also provide the "enabling environment for the private sector to purchase technologies that it views as profitable" (Sachs *et al.* 1998). Finally, the government must increase its investment in education, particularly science and engineering education, and improve science education at all levels.

Required action:	Administrative
Agencies involved:	National Economic and Development Authority Department of Trade and Industry Department of Education and Sports Department of Public Works and Highways

h. Agricultural Development

To support agricultural development, the government must act on the following issues:

First, to encourage long-term investments in land improvements and tree crops and develop an efficient land market, the government must change its policy of retaining ownership of lands with slope beyond 18 degrees and prohibition of sale of lands transferred to the agrarian reform beneficiaries under the Comprehensive Agrarian Reform Law.

Second, rural transportation infrastructure must be substantially improved to reduce transport cost and bring farmers closer to their markets for farm produce and inputs.

Third, investment in agricultural research, which will have very high return in the long-run yet grossly underfunded by the government compared to those of developing countries needs to be increased substantially. However, this should be accompanied by a reform of the agricultural research and development system.

Fourth, agricultural trade policy must be reviewed especially in light of the huge depreciation of the domestic currency vis-à-vis the US dollar. More specifically, the huge peso depreciation can allow for a significant reduction of the currently high import tariffs of major agricultural commodities, which will bring benefits to exportable commodities as well as to the hog and poultry industries without necessarily hurting the import-competing commodities.

Required action:	Legislative and administrative
Agencies involved:	Congress
	Department of Agriculture
	Department of Agrarian Reform
	National Economic and Development
	Authority
	Department of Science and Technology

VI. ROLE OF DONOR AGENCIES

The discussions in the previous section indicate that to stage a rapid economic recovery in the short-run and a sustainable growth in the long-run, the Philippines needs resources far in excess of what it can mobilize internally. It, therefore, needs four types of external assistance from donor agencies/countries. The first type is ***budget support*** to support the pump-priming activities of the government in the next two years without unduly exerting pressure on domestic interest rate. This fiscal stimulus is necessary to fill up the gap left behind by the private sector during this crisis period. The second type of external assistance is ***balance-of-payments support*** which is needed to reduce pressure on exchange rate as imports rise faster than exports and the BSP builds up its reserves against the background of continued weakness in private capital flows during the recovery period. The third type is the traditional ***project financing support*** meant to address the development infrastructure (physical and human) requirements of the country. These are financial assistance for specific large-scale projects, such as road networks, fishing ports, school buildings, health programs, etc. The fourth type of external assistance is ***technical assistance***, which will be utilized to study some issues that could lead to major policy or institutional changes or that could serve as basis for designing and implementing major projects, and to build institutional capacities to support economic recovery and/or sustain the growth momentum. All four are various forms of ***official development assistance***, except that the first two are resorted only during exceptional circumstances like the currency crisis facing many Asian countries today.

Donor agencies will continue to be an important source of external assistance for the Philippines at least for the next decade. In the past, most donor agencies have been mainly providing project financing and technical assistance support to the Philippines, which complemented the same types of assistance provided by other bilateral and multilateral donor agencies. Donor agencies are expected to play these roles in the next decade.

However, one lesson that can be learnt from the present Asian currency crisis as well as from previous crises that struck the Philippines is that the effectiveness of project financing support can be undermined by short-term fluctuations in the economy. For example, during cyclical downturn of the economy, the government usually does not have enough resources to maintain existing key infrastructures, such as irrigation, ports, roads, etc., much less to raise counterpart funds for new strategic projects. The speed of the economic recovery can be constrained by inadequate and poorly maintained infrastructures. Also, during crisis periods, investments in health and education are usually cut in real terms, which have adverse implications on human development and labor productivity in the long-term. Moreover, reforms that are necessary to restructure the economy and strengthen key sectors in the long-run are often postponed as the government narrowly focuses its attention and resources to short-term issues that need quick fixing. This can make economic recovery unsustainable. Much worse is that as the crisis deepens, support for structural reforms can dwindle and the threat of policy reversal can become real. Finally, the economic recovery can immediately die down if the external financing gap that will arise from sudden increased economic activities cannot be covered.

All this suggests that donor agencies consider in their official development assistance program the provision of balance of payments and budget support to developing countries to increase their chances of getting out of the short-term economic crisis with the injection of additional external assistance. The budget support is to be used to protect key economic activities or sectors of the economy from the budget cuts and, at the same time, spur economic growth in the short-term. These are essentially pump-priming activities of the government.

The balance of payments support, on the other hand, may be used either for commodity imports or for servicing external debts in the short-run so that other resources could be freed up for other purposes. Donor agencies' provision of this support should, however, be tied up with efforts of the recipient country to carry out specific reform programs to make the recovery sustainable in the long-run.

From the point of view of the recipient country, funds are fungible, and the budget support could end up as balance of payments support. For the donor country, however, budget support can be more administratively cumbersome and more difficult to monitor than balance of payments support. Nonetheless, this is not an insurmountable problem, and developing such capacity within donor agencies can be considered its greatest challenge.

The provision of balance of payments and budget support is the role historically played by multilateral agencies. However, there are reasons why bilateral donor agencies also need to play this role in the context of its development assistance program to developing countries to complement those of multilateral institutions. First, as is mentioned earlier, the provision of balance of payments and budget support to countries encountering short-term stabilization problems can improve the effectiveness of its traditional official development assistance. Second, unexpected external shocks sometimes hit an otherwise stable (donor-recipient) economy, which requires quicker response to soften the negative impacts of such shocks on the domestic economy. Bilateral donors like OECF can be more flexible and can more quickly respond to the needs of a country encountering short-term crisis than multilateral donors. Third, the crises in the recent past and the present one are not isolated anymore or country-specific but are rather regional in nature due to globalization. Addressing such crisis would require resources and expertise far in excess of what multilateral institutions can provide.

In the Philippines, to move funds quickly for budget and balance of payments support in the next few months, donor agencies may start with co-financing schemes, i.e., augmenting resources of existing projects or projects in the pipeline funded by multilateral institutions, and eventually move towards the financing of new programs or projects identified by the government. The table below presents a summary of some actions that the government could take both in the short-term and in the medium- and long-term, the specific instruments to concretize the proposed actions, and the form of assistance donor agencies may provide to the government for each specific action.

ROLE OF DONOR AGENCIES FOR THE PHILIPPINES' ECONOMIC RECOVERY

Time Frame	Action Plans	Specific Instruments	Role of Donor Agencies
Short-term	a. Pump-priming		
	1. Agriculture – infrastructure programs	Legislative	Budget support
	2. Health – increase MOOE	Legislative	Budget support
	3. Education – increase MOOE and capital outlay	Legislative	Budget support
	4. Housing – (i) Capital grant (ii) Reform of the NHMFC (iii) Increase capital of HIGC	(i) Legislative (ii) Legislative (iii) Legislative	(i) Budget support (ii) Budget support (iii) Budget support
	5. Credit programs- (i) Rationalization of special credit programs (ii) additional funds for SMEs	(i) Administrative (ii) Administrative	(i) Technical assistance (ii) Budget support
	b. Resource Mobilization		
	1. Renegotiation of short-term bridge financing loan	Administrative	None
	2.Privatization (i) Sale of remaining shares of PNB (ii) Sale of remaining shares of Petron (iii) FTI (iv) NPC (v) PNOC-EDC	(i) Administrative (ii) Administrative (iii) Administrative (iv) Legal and Administrative (v) Administrative	(i) BOP support (ii) BOP support (iii) Technical assistance and BOP support (iv) Technical assistance and BOP support (v) Technical assistance and BOP support
	3. Financial sector reforms (i) Passage of the General Banking Act (ii) Passage of the new Securities Act (iii) Passage of the new Investment Company Act	(i) Legislative (ii) Legislative (iii) Legislative	(i) BOP support (ii) BOP support (iii) BOP support
	4. Bond issuance	Administrative	None

(Cont'd.)

Time Frame	Action Plans	Specific Instruments	Role of Donor Agencies
Medium- and Long-term	a. Monetary, Banking and Exchange Rate Policies		
	(i) <i>Review of the conduct of its monetary and exchange rate policy</i>	(i) <i>Administrative</i>	(i) <i>Technical assistance</i>
	(ii) <i>Development of an early warning system for BOP and financial crisis</i>	(ii) <i>Administrative</i>	(ii) <i>Technical assistance</i>
	(iii) <i>Improvement in the information system on capital flows</i>	(iii) <i>Administrative</i>	(iii) <i>Technical assistance</i>
	b. Competition Policy Framework		
	(i) <i>Passage of a legal framework</i>	(i) <i>Legislative</i>	(i) <i>Technical Assistance</i>
	(ii) <i>Establishment and Capacity building of regulatory agency</i>	(ii) <i>Legislative and Administrative</i>	(ii) <i>Technical Assistance</i>
	c. Establishing competitive infrastructure sectors		
	(i) <i>Formulation of legal and regulatory framework</i>	(i) <i>Legislative</i>	(i) <i>Technical assistance and BOP support</i>
	(ii) <i>Strengthening of regulatory agencies</i>	(ii) <i>Administrative</i>	(ii) <i>Technical assistance</i>
	d. Improved tax revenues		
	(i) <i>Rationalization of fiscal incentives and subsidies</i>	(i) <i>Legislative</i>	(i) <i>Technical assistance</i>
	(ii) <i>Improving tax administration</i>	(ii) <i>Administrative</i>	(ii) <i>Technical assistance</i>

Time Frame	Action Plans	Specific Instruments	Role of Donor Agencies
	e. Taxes on financial sector (i) <i>tax treatment of loan loss provisions of banks</i> (ii) <i>phase-out of DST</i> (iii) <i>Replacement of GRT</i>	(i) <i>Legislative</i> (ii) <i>Legislative</i> (iii) <i>Legislative</i>	(i) <i>Technical assistance</i> (ii) <i>None</i> (iii) <i>None</i>
	f. Pension fund system reform	(i) <i>Legislative</i>	(i) <i>Technical assistance</i>
	g. Industrial Restructuring <i>Infrastructure projects to reduce the cost of doing business</i>	<i>Legislative and administrative</i>	<i>Traditional ODAs</i>
	h. Agricultural Development (i) <i>Review and reform of policies on land sale and transfer</i> (ii) <i>Improvement of rural infrastructure</i> (iii) <i>Increase investment in agricultural research and reform of the agricultural research system</i> (iv) <i>Review of agricultural trade policy</i>	(i) <i>Legislative</i> (ii) <i>Legislative and administrative</i> (iii) <i>Legislative and administrative</i> (iv) <i>Legislative</i>	(i) <i>None</i> (ii) <i>Traditional ODAs</i> (iii) <i>Traditional ODAs</i> (iv) <i>Technical assistance</i>

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FINANCIAL SECTOR RESTRUCTURING IN THE 1980s AND EARLY 1990s¹²

The history of the Philippine financial system is littered with institutional failures, which were not limited only to small institutions but to large ones as well. During times of rapid economic growth, financial institutions relaxed their lending criteria and took on more risks. This was done under an environment of weak regulatory framework and supervision. As often the case, slowdown of the economy exposed the weaknesses of financial institutions and eventually led to the collapse of many of them.

By far, failures of several financial institutions in the 1980s were the worst in Philippine history. The country entered the decade of the 1980s with an economy that started to slowdown. Then, a severe liquidity crisis struck the financial system in 1981 when a large borrower failed to honor his huge obligations to several banks and non-bank financial institutions (i.e., investment houses and finance companies). Although signs of weaknesses of several financial institutions started to appear, the central bank took time to quickly resolve them, hoping that they can restore their financial health. But as the financial sector started to recover, a devastating balance-of-payments problem hit the economy, aggravating the problems of many financial institutions. The government tried to rescue five commercial banks by injecting more funds into them. When this strategy failed, the government eventually ended up owning the closed banks. The non-performing assets of these banks were cleaned up and the government sold the rehabilitated banks back to the private sector. Apart from the rehabilitated commercial banks, the government during the period 1981-1987 closed 3 commercial banks, 32 thrift banks and 138 rural banks. The government launched a massive rehabilitation program for the rural banking system, in which about half of the remaining 1,000 rural banks participated in the program. Others opted out anticipating that they could no longer meet the stringent requirements of the rehabilitation program. Several large finance and investment houses, which borrowed heavily from the market, were also closed.

Saddled by huge non-performing assets, the two large government-owned banks, the Development Bank of the Philippines (DBP) and the Philippine National Bank (PNB) also collapsed in the mid-1980s. The rescue operation done by the government to clean up the non-performing assets and contingent liabilities of these banks resulted in the transfer to the government of about P108 billion worth of non-performing assets. Presently, 43 percent of the total outstanding shares of the PNB is already owned by the private sector.

The central bank's financial assistance to troubled financial institutions was by no means small. It went up to as high as 47 percent of reserve money during the first quarter of 1986.

¹² A more detailed discussion of this issue can be found in Mario B. Lamberte, "Assessment of the Problems of the Financial System: The Philippine Case," PIDS Working Paper Series No. 89-18 (December 1989).

Several causes could be attributed to the collapse of several financial institutions in the 1980s, but the most important of them was insider lending or lending to bank directors, officers, stockholders, and related interests (DOSRI). Usually, a bank, which is part of a conglomerate, lends to its DOSRI or affiliates, which, in turn, use the funds for very risky ventures. If the investment succeeds, then the DOSRI and/or affiliates reap all the benefits. If it fails, the bank may not report the losses so that bad loans will not be reflected in its books. Or it may understate the losses arising from such loans in order to prevent a bank run. In any case, the bank would not be reporting anymore its real financial position until such problem turns into a crisis proportion. Most often, the DOSRI ceilings were violated by failing banks.

While insider abuse was committed by some private bankers, fraud was committed at the highest level in government in the case of financial collapse of DBP and PNB. These financial institutions were saddled with behest loans and credit guarantees that went sour. Behest loans and guarantees were accommodations which could have not been granted by these banks to President Marcos' relatives, "cronies" and associates were it not for his pressure and /or personal endorsements.

Weak regulation and supervision contributed to insider abuse. The central bank can examine banks only once a year, and most of the violations of DOSRI loan ceilings were made in between examination periods. Also, although the central bank examiners might be able to see violations of DOSRI loan ceilings, which they promptly brought to the attention of banks concerned for correction, in cases where dummies were used, they usually found it difficult to prove the flow of funds from the dummies to the DOSRI (when made through the deposit accounts) because they could not examine any deposit account. The Secrecy of Bank Deposit Law is preventing them from doing that.

Since 1986, several measures were introduced to liberalize and, at the same time, strengthen the regulatory framework for the financial system (see **Appendix A – Table 1**). For instance, the central bank raised the minimum capital requirement for banks three times during the period 1986-1994, forcing undercapitalized banks to merge with other banks. Although the Secrecy of Bank Deposit Law was left intact, the central bank tightened regulations on DOSRI loans. More importantly, the central bank made it clear in a written policy that it would refrain from sustaining weak banks.

The Philippine financial system entered the decade of the 1990s better capitalized and with a much healthier balance sheet. In fact, none of the banks went under during the 1991-1992 economic slowdown and the Treasury bill scam in 1993 that caused a run on some banks. It cannot be denied that the policy of bank closure, which was applied to several ailing banks in the past, has kept pressure on bank owners and managers to be more prudent in managing their banks.

Because of liberal bank entry and bank branching policy espoused by the central bank in the 1990s, the number of commercial banks increased from 29 in 1990 to 54 in 1997, while the number of commercial bank offices rose from 1,863 to 4,078. There is now greater participation of foreign banks in the domestic banking system as can be seen from the entry

of 4 subsidiaries of foreign banks and 10 branches of foreign banks. Intermediation has greatly improved as can be observed from the rise of M3/GNP ratio from 27.9 percent in 1990 to 42.2 percent in 1997. With more banks and bank branches opened in a number of places in the country, the general public's access to a variety of financial services at more favorable terms has greatly improved.

But all is not well, however. Most recently, a newly opened small commercial bank collapsed primarily due to mismanagement and insider abuse. This shows that the existing regulatory and supervisory framework for dealing with insider abuse remains weak. Indeed, the General Banking Act needs to be amended to strengthen internal governance of banks, impose greater market discipline and improve the oversight of banks. Also, the Secrecy of Bank Deposit Law must be amended to give more teeth to bank supervisors and examiners.

Appendix A - Table 1. Financial Sector Reform in the Philippines, 1986-1994

Policy Measures	Before Reform	After Reform	Date
I. Selective Credit Control			
1. Central Bank rediscount window	Rediscount rate: varies by type of economic activities (allowable spread: 1%-11%) Rediscount value: varies by type of economic activities (value: 60%-100%)	Uniform floating rate for all; no prescribed spread. Uniform: 80%	November 1985 November 1985
2. Central Bank special credit programs	Directly managed special credit programs	Central Bank-managed special credit programs transferred to government financial institutions	1987-1988
II. Bank Competition			
1. Bank Entry	New commercial banks - moratorium since 1980; Other banks - no moratorium. Foreign banks - no entry since 1949.	New commercial banks - moratorium lifted Ten foreign banks allowed to have 6 branches each; foreign banks may acquire or establish a bank up to 60% of the total equity of each bank.	1989 1994

2. Branching	Restrictive branching policy - the country was divided into five service areas: heavily overbranched areas; overbranched areas; ideally branched areas; underbranched areas; and encouraged branching areas.	Branching was liberalized but the Central Bank retained discretionary power with respect to the opening of branches in certain areas considered "overbanked". Banks may open branches anywhere they like provided they meet the required minimum capital requirement.	May 1989 May 1993
3. Government Banks	Largely doing retail lending that directly competes with private banks	More focus on wholesale lending using private banks as conduits.	since 1987
4. Interest Rates			
a. Deposit rates	No cap since 1981		
b. Lending rates	No cap since 1983		
Private banks	Cap on end-user rate	same	1987
Special credit programs		No cap on end-user	

III. Prudential Measures			
		Prohibiting concurrent officerships between banks or between a bank and a non-bank financial intermediary except with prior approval of the Monetary Board.	September 1986
		Requiring each bank to cause an annual financial audit to be conducted by an external independent auditor not later than 30 days after the close of the calendar year.	December 1986
		Requiring all banks and non-bank financial intermediaries to adopt the Statements of Financial Accounting Standards.	December 1987

		<p>The Central Bank declared a policy that it shall refrain from sustaining weak banks, except in times of general financial emergency or when specific banks face problems of liquidity rather than Of solvency.</p>	May 1989
		<p>Including contingent liabilities in the determination of the limit to which banks can lend to a single borrower or a group of affiliated borrowers.</p>	June 1993
		<p>Insider-borrower shall waive the secrecey of their deposits for examination purposes. Increasing the minimum capital requirements for banks.</p>	
	Deposits of insider-borrower were protected by the Secrecy of Bank Deposits Law.	Increasing the minimum capital requirements for banks.	

IV. Foreign Exchange Markets			
1. Foreign exchange trading	On-floor	Off-floor through an electronic screened-based network for sharing information and undertaking transactions.	December 1992
2. Export receipts	Mandatory surrender of foreign exchange receipts.	Foreign exchange earners may retain 100% of total receipts and can use them freely without prior Central Bank authorization.	September 1992
3. Foreign exchange purchases	Limits on foreign exchange purchases such as travel, educational expenses, etc.	No limit.	September 1992
4. Repatriation and remittances of investments	Staggered from 3-9 years subject to Central Bank approval.	Full and immediate repatriation without Central Bank approval for foreign investments duly registered with the Central Bank or custodian bank.	September 1992
5. Outward investment by residents	Not allowed.	Allowed initially up to US\$1M, but lately increased to US\$6M.	1992 - 1994
6. Access to domestic FCDU loans.	No access.	Direct exporters allowed access.	September 1992
		Indirect exporters allowed access	July 1994

Source: Mario B. Lamberte, "Recent Financial Structure Reforms and Macroeconomic Management in the Philippines," PIDS (February 1995).

Figure 1
Ratio of M3/GNP (1980-1997)

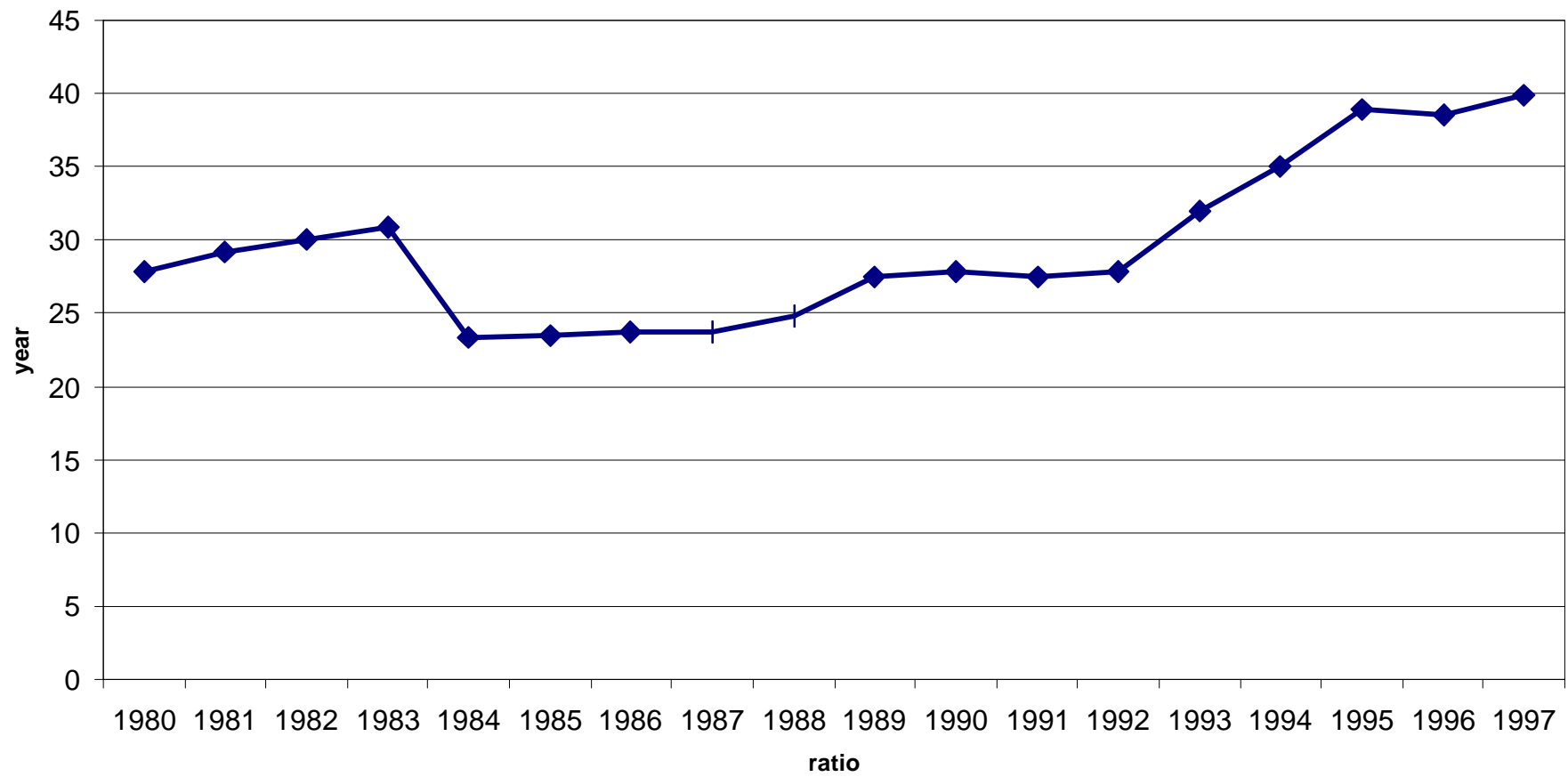


Figure 2
REER of Selected Asian Countries 1975-1996

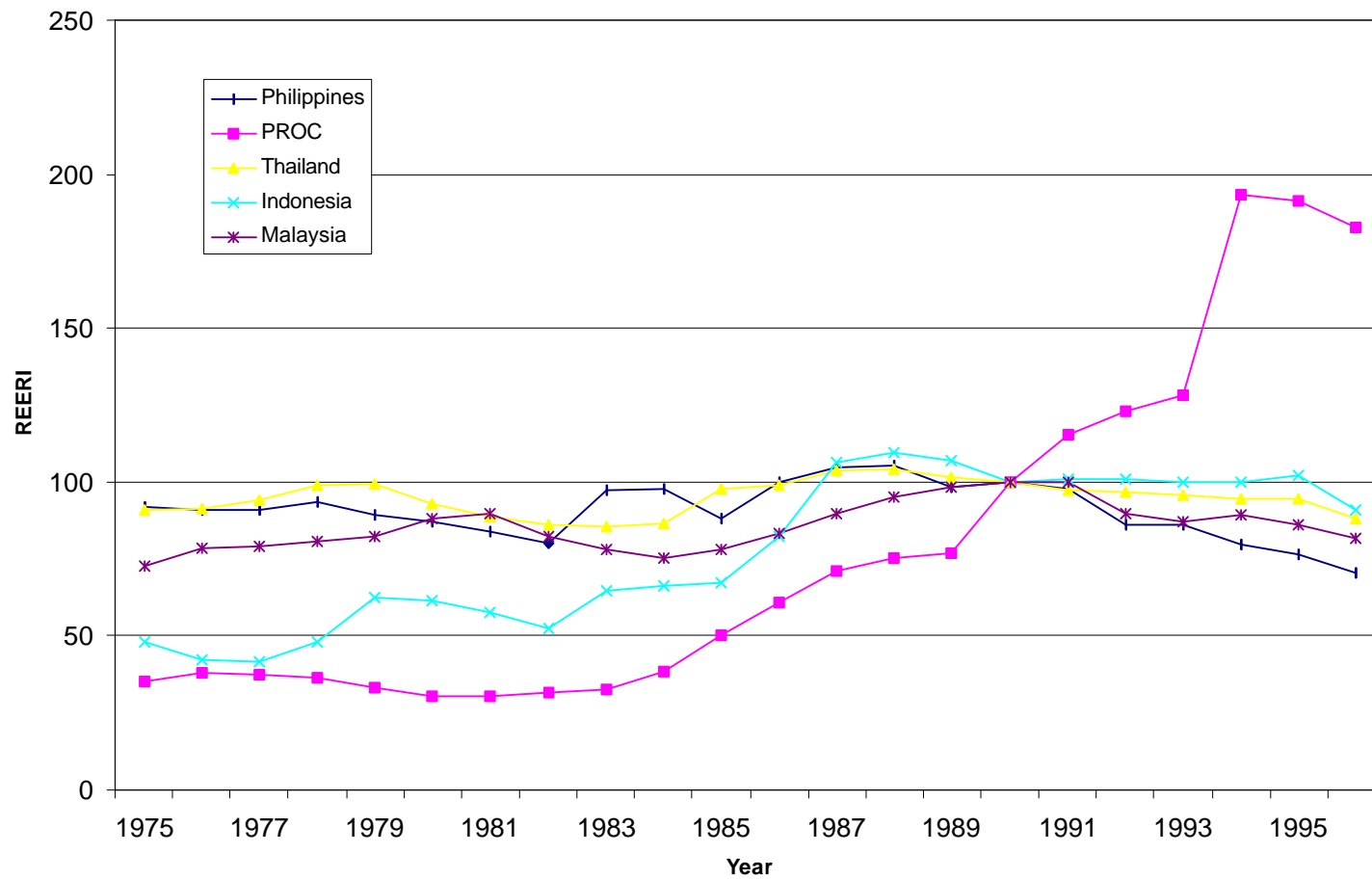


TABLE 1. SELECTED ECONOMIC INDICATORS
Annual Data: 1990 - 1998

	1990	1991	1992	1993	1994	1995	1996	1997	1998
GNP Growth Rate	5.40	0.20	1.50	1.30	5.30	5.00	7.20	5.30	0.30 e/
GDP Growth Rate	3.20	-0.60	0.40	2.10	4.40	4.80	5.80	5.20	0.00 e/
Inflation	14.20	18.70	8.90	7.60	9.10	8.10	8.50	5.10	9.70 b/
CPSD/GNP (%)	-4.70	-2.10	-1.90	-1.70	-0.50	-0.20	0.30	-0.90	
NG Fiscal Position/GNP (%)	-3.50	-2.10	-1.20	-1.50	0.90	0.60	0.30	0.10	-1.44 e/
Interest Rate	23.70	21.50	16.00	12.40	12.70	11.80	12.30	13.10	13.50 c/
Export Growth	4.67	7.99	11.13	15.79	18.53	29.40	17.75	22.81	19.16 d/
Import Growth	17.15	-1.27	20.48	21.20	21.23	23.71	20.82	14.02	-14.16 d/
GDCF/GDP (ratio)	0.24	0.20	0.21	0.23	0.24	0.23	0.25	0.26	0.22 a/
Total Trade/GDP (ratio)	0.68	0.69	0.74	0.79	0.88	0.96	1.06	1.16	1.06 a/

a/ 1st-3rd quarter average

b/ January-November average

c/ October

d/ January - July total

e/ forecast

TABLE 2. SELECTED EXTERNAL DEBT RATIOS 1/**Annual Data: 1990 - 1998****Amount in million US dollars; Ratios in percent**

Item	1990	1991	1992	1993	1994	1995	1996	1997
I. Debt Service Burden (DSB) 2/								
Total	3,547	2,828	2,942	3,229	4,188	5,032	5,026	5,440
Principal	1,712	1,140	1,607	1,791	2,647	2,853	2,820	2,921
Interest	1,835	1,688	1,335	1,438	1,541	2,179	2,206	2,519
Export Shipments	8,186	8,840	9,824	11,375	13,483	17,447	20,543	25,228
Exports of Goods & Services	13,028	14,464	17,267	18,872	24,033	31,821	39,549	48,063
Current Account Receipts	13,745	15,292	18,093	19,618	25,074	32,968	40,734	49,733
Gross National Product	44,073	45,656	53,889	55,321	65,742	76,180	87,084	85,742
Foreign Exchange Liabilities (End-of-Period)	28,549	29,956	30,934	34,282	37,079	37,778	41,875	45,433
Gross International Reserves (End-of-Period)	2,048	4,526	5,338	5,922	7,122	7,762	11,745	8,768
II. Ratios								
DSB to Export Shipments	43.33	31.99	29.95	28.39	31.06	28.84	24.47	21.56
DSB to Exports of Goods & Services	27.23	19.55	17.04	17.11	17.43	15.81	12.71	11.32
DSB to Current Account Receipts	25.81	18.49	16.26	16.46	16.70	15.26	12.34	10.94
DSB to Grrs National Product	8.05	6.19	5.46	5.84	6.37	6.61	5.77	6.34
Foreign Exchange Liabilities to Gross National Product	64.78	65.61	57.40	61.97	56.40	49.59	48.09	52.99
Gross International Reserves to Debt Service Burden	57.74	160.04	181.44	183.40	170.06	154.25	233.68	161.18

Notes:

1 Based on the revised methodology.

2 Debt service burden represents principal and interest payments after rescheduling.

Source: SPEI, Bangko Sentral ng Pilipinas

TABLE 3. FOREIGN EXCHANGE FLOWS
In Million US Dollars

Levels	1990	1991	1992	1993	1994	1995	1996	1997
Trade Balance	-4020	-3211	-4695	-6222	-7850	-8944	-11342	-10708
Current Account	-2567	-869	-858	-3016	-2950	-3297	-3914	-4303
Short-Term Capital, net	19	349	660	-148	1002	-56	540	495
MLT Loans, net	674	835	633	2455	1313	1276	2690	4688
FDI, net	528	529	675	864	1289	1361	1338	1117
Portfolio, net	-56	125	62	-52	269	248	-170	-461
Non-residents, net	-52	125	155	897	901	1485	2101	-55
KBs	603	40	289	-299	674	1574	4211	1191
Share to GDP								
Trade Balance	-9.07	-7.07	-8.86	-11.44	-12.25	-12.06	-13.54	-12.87
Current Account	-5.79	-1.91	-1.62	-5.55	-4.60	-4.45	-4.67	-5.17
Short-Term Capital, net	0.04	0.77	1.25	-0.27	1.56	-0.08	0.64	0.59
MLT Loans, net	1.52	1.84	1.19	4.52	2.05	1.72	3.21	5.63
FDI, net	1.19	1.16	1.27	1.59	2.01	1.84	1.60	1.34
Portfolio, net	-0.13	0.28	0.12	-0.10	0.42	0.33	-0.20	-0.55
Non-residents, net	-0.12	0.28	0.29	1.65	1.41	2.00	2.51	-0.07
KBs	1.36	0.09	0.55	-0.55	1.05	2.12	5.03	1.43

Source: BSP, Selected Philippine Economic Indicators

TABLE 4. FOREIGN EXCHANGE LIABILITIES
As of the dates indicated
In million US dollars

	1990		1991		1992		1993		1994 a/		1995 a/		1996		1997	
	Amount	% Share to Total	Amount	% Share to Total	Amount	% Share to Total	Amount	% Share to Total	Amount	% Share to Total	Amount	% Share to Total	Amount	% Share to Total	Amount	% Share to Total
By Type of Debt	28549	100	29956	100	30934	100	34282	100	37079	100	37778	100	41875	100	45433	100
Medium and Long-Term 1/	24173	84.67	25129	83.89	25678	83.01	29247	85.31	31882	85.98	32499	86.03	34668	82.79	36994	81.43
IMF	997	3.49	1165	3.89	1183	3.82	1312	3.83	1139	3.07	814	2.15	405	0.97	889	1.96
Others	23176	81.18	23964	80	24495	79.18	27935	81.49	30743	82.91	31685	83.87	34263	81.82	36105	79.47
Short-Term	4376	15.33	4827	16.11	5256	16.99	5035	14.69	5197	14.02	5279	13.97	7207	17.21	8439	18.57
Trade	4099	14.36	4589	15.32	4937	15.96	3495	10.19	3401	9.17	2674	7.08	4096	9.78	4032	8.87
Non-Trade	277	0.97	238	0.79	319	1.03	1540	4.49	1796	4.84	2605	6.9	3111	7.43	4407	9.70
By Borrower	28549	100	29956	100	30934	100	34282	100	37079	100	37778	100	41875	100	45433	100
Non-Banking	20744	72.66	22491	75.08	26720	86.38	31879	92.99	34052	91.84	33591	88.92	33244	79.39	34768	76.53
Public	16958	59.4	18453	61.6	21745	70.29	26583	77.54	27193	73.34	26340	69.72	24132	57.63	22271	49.02
Public (NG & Others)							24969	72.83	25526	68.84	24886	65.87	22943	54.79	21393	47.09
Central Bank - BOL							1614	4.71	1667	4.5	1454	3.85	1189	2.84	878	1.93
Private	3786	13.26	4038	13.48	4975	16.08	5296	15.45	6859	18.5	7251	19.19	9112	21.76	12497	27.51
Banking	7805	27.34	7465	24.92	4214	13.62	2403	7.01	3027	8.16	4187	11.08	8632	20.61	10664	23.47
Central Bank of the Phils.	5481	19.2	5325	17.78	2303	7.44										
Bangko Sentral ng Pilipinas							1288	3.76	855	2.31	1212	3.21	1415	3.38	2499	5.50
Banks	2324	8.14	2140	7.14	1911	6.18	1115	3.25	2172	5.86	2975	7.87	7217	17.23	8165	17.97
By Creditor	28549	100	29956	100	30934	100	34282	100	37079	100	37778	100	41875	100	45433	100
Banks & Other Financial Inst	11491	40.25	11007	36.74	9407	30.41	5985	17.46	5529	14.91	6345	16.8	8373	20	10176	22.40
Suppliers	2312	8.1	2802	9.35	2963	9.58	3185	9.29	3549	9.57	2587	6.85	2588	6.18	2359	5.19
Multilateral	6005	21.03	6499	21.7	7168	23.17	7949	23.19	8216	22.16	8028	21.25	8634	20.62	8638	19.01
Bilateral	8547	29.94	9572	31.95	11328	36.62	13369	39	15033	40.54	14393	38.1	13439	32.09	13307	29.29
Others	194	0.68	76	0.25	68	0.22	3794	11.97	4752	12.82	6426	17.01	8841	21.11	10953	24.11

a/ As adjusted; excludes "Due to Head Office/Branches Abroad" accounts amounting to \$519 million for end-1994 and \$861 million for end-1995.

1/ Includes cumulative foreign exchange revaluation on US\$ denominated multi-currency loans from World Bank and the ADB of \$817 million for end-1996, \$417 million for Mar 1997 and \$587 million for Jun 1997.

Source: Bangko Sentral ng Pilipinas (BSP)

TABLE 5. FOREIGN CURRENCY DEPOSIT UNIT LOANS
In Million US Dollars

LEVELS	1993	1994	1995	1996	1997
Commodity Exporter	1108.9	1715.8	2985.8	5868	5171.2
Service Exporter	44.1	56.3	107.5	285.6	351.09
Producers/ Manufacturer	18.5	14.6	56.6	89.3	150.47
Oil Companies	492.4	538.7	400.3	448.7	402.13
Public Utilities	335	448.6	869.6	1484.5	1614.6
Others	16.1	320.5	614	2400.8	2713.5
TOTAL	2015	3094.5	5033.8	10576.9	10403
SHARE TO TOTAL					
Commodity Exporter	55.03	55.45	59.32	55.48	49.71
Service Exporter	2.19	1.82	2.14	2.70	3.37
Producers/ Manufacturer	0.92	0.47	1.12	0.84	1.45
Oil Companies	24.44	17.41	7.95	4.24	3.87
Public Utilities	16.63	14.50	17.28	14.04	15.52
Others	0.80	10.36	12.20	22.70	26.08
TOTAL	100	100	100	100	100

Source: Bangko Sentral ng Pilipinas

TABLE 5a. NATIONAL GOVERNMENT REVENUES
In Million Pesos

	ACTUAL													PROJECTIONS			
	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
REVENUES	79245	103214	112861	152410	180902	220787	242714	260405	336160	361220	410449	471841	462515	550500	601500	666700	740800
Tax Revenues	65491	85923	90352	122462	151700	182275	208705	230170	271305	310517	367894	412163	416585	507200	563200	628000	701900
Bureau of Internal Revenue	46804	58600	63721	82001	103985	116256	133904	145927	187445	210195	260774	314695	337175	408100	457600	511700	575900
Domestic-based	46454	58322	63155	81464	103368	115682	133207	145207	186738	209913	260490	314308	na				
Net Income & Profits	19148	21799	27409	37592	49366	61053	70123	74795	91885	109353	136356	164170	na				
Excise Tax	16383	22641	19597	24857	28875	25411	27629	30259	39596	41115	48389	63049	na				
Sales Taxes & Licenses	9245	12132	12356	15687	20266	24204	27794	33458	36450	43259	59300	67671	na				
Other Domestic taxes	1678	1750	3793	3328	4861	5014	7661	6695	18807	16186	16445	19418	na				
Internal	350	278	566	537	617	574	697	720	707	282	284	387	na				
Travel Tax	324	278	566	537	617	574	697	720	707	282	284	387	na				
Forex Tax	26																
Bureau of Customs	17496	25992	25014	38375	45948	64391	72870	81971	81610	97601	104566	94800	76005	93200	94500	104300	113100
Import of Duties & Taxes	16859	25977	25011	38375	45948	64391	72870	81971	81610	97601	104566	94800	76005				
Export Taxes	637	15	3														
Other Offices	1191	1331	1617	2086	1767	1628	1931	2272	2250	2721	2554	2668	3405	5900	11100	12000	12900
Non-Tax Revenues	13754	17291	22509	29948	29202	38512	34009	30235	64855	50703	42555	59678	45930	43300	38300	38800	38800
BTr Income	1961	5751	9211	14190	14217	22049	20069	19414	21495	15885	24593	35352	22535	15200	18300	17800	16900
Fees and other charges	5182	5369	5322	5114	5726	7213	5889	6917	12714	11001	11733	13160	21046	17500	18800	19700	20700
Sale of Assets		1253	6006	4176	4181	4119	1877	1677	29914	22776	5660	9428	1717	10400	1000	1000	1000
of which: BCDA										18486	4113	4170					
CARP													236				
Compromise Settlement										53							
Economic Support Fund	6150	3116	195	4767	2044	1659	1704	481									
Grants	199	1393	1775	1701	2380	3072	2144	1551	732	988	569	1738	396	200	200	200	200
Foreign	199	1393	1404	1357	2262	3009	1744	1515	732	988	569	1738	396				
Domestic			371	344	118	63	400	36									
Others	262	409			654	400	2326	195									

Source: Actual figures are from the Bureau of Treasury

TABLE 5b. NATIONAL GOVERNMENT REVENUES - PERCENT OF GNP
In Million Pesos

	ACTUAL													PROJECTIONS				
	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
REVENUES	13.4681	15.5106	14.4311	16.8323	16.8841	17.5987	17.654	17.357	19.3598	18.4396	18.1507	18.6728	16.5817	17.4	17.1	17.1	17.2	17.7
Tax Revenues	11.1305	12.9122	11.5529	13.5249	14.1586	14.529	15.1803	15.3417	15.6247	15.8513	16.2689	16.3111	14.935	16	16	16.1	16.3	16.9
Bureau of Internal Revenue	7.95457	8.80616	8.14775	9.05629	9.70523	9.26666	9.73962	9.72661	10.7951	10.7301	11.5318	12.4538	12.0881	12.9	13	13.1	13.4	13.7
Domestic-based	7.89509	8.76439	8.07537	8.99698	9.64764	9.22091	9.68892	9.67861	10.7544	10.7157	11.5193	12.4385	na					
Net Income & Profits	3.2543	3.27586	3.50468	4.15171	4.60747	4.86648	5.10046	4.98538	5.29175	5.58228	6.02988	6.49692	na					
Excise Tax	2.78437	3.4024	2.50579	2.74524	2.69499	2.02549	2.00962	2.01688	2.28037	2.09885	2.13984	2.49512	na					
Sales Taxes & Licenses	1.57123	1.82315	1.57991	1.73249	1.89149	1.92928	2.02162	2.23011	2.09919	2.2083	2.62234	2.67803	na					
Other Domestic taxes	0.28518	0.26298	0.485	0.36755	0.45369	0.39966	0.55723	0.44625	1.08311	0.82627	0.72722	0.76845	na					
Internal	0.05948	0.04178	0.07237	0.05931	0.05759	0.04575	0.0507	0.04799	0.04072	0.0144	0.01256	0.01532	na					
Travel Tax	0.05507	0.04178	0.07237	0.05931	0.05759	0.04575	0.0507	0.04799	0.04072	0.0144	0.01256	0.01532	na					
Forex Tax	0.00442																	
Bureau of Customs	2.97353	3.90597	3.19844	4.23818	4.28846	5.13255	5.30026	5.46369	4.7	4.98236	4.62407	3.75165	2.72487	2.9	2.7	2.7	2.6	2.9
Import of Duties & Taxes	2.86527	3.90372	3.19806	4.23818	4.28846	5.13255	5.30026	5.46369	4.7	4.98236	4.62407	3.75165	2.72487					
Export Taxes	0.10826	0.00225	0.00038															
Other Offices	0.20242	0.20002	0.20676	0.23038	0.16492	0.12977	0.14045	0.15144	0.12958	0.1389	0.11294	0.10558	0.12207	0.2	0.3	0.3	0.3	0.3
Non-Tax Revenues	2.33756	2.59842	2.87813	3.30749	2.72551	3.06976	2.47367	2.01528	3.73507	2.5883	1.88185	2.36172	1.64664	1.4	1.1	1	0.9	0.9
BTr Income	0.33328	0.86424	1.17777	1.56716	1.32691	1.75751	1.45974	1.29402	1.23792	0.8109	1.08754	1.39903	0.80791	0.5	0.5	0.5	0.4	0.4
Fees and other charges	0.88071	0.80683	0.6805	0.5648	0.53442	0.57494	0.42834	0.46105	0.73221	0.56158	0.51885	0.5208	0.75452	0.6	0.5	0.5	0.5	0.5
Sale of Assets		0.1883	0.76796	0.4612	0.39023	0.32832	0.13653	0.11178	1.72278	1.16267	0.25029	0.37311	0.06156	0.3	0	0	0	0
of which: BCDA										0.94368	0.18188	0.16502						
CARP													0.00846					
Compromise Settlement										0.00271								
Economic Support Fund	1.04522	0.46826	0.02493	0.52647	0.19077	0.13224	0.12394	0.03206										
Grants	0.03382	0.20933	0.22696	0.18786	0.22213	0.24487	0.15595	0.10338	0.04216	0.05044	0.02516	0.06878	0.0142	0	0	0	0	0
Foreign	0.03382	0.20933		0.17952	0.14987	0.21112	0.23984	0.12685	0.10098	0.04216	0.05044	0.02516	0.06878	0.0142				
Domestic			0.04744	0.03799	0.01101	0.00502	0.02909	0.0024										
Others	0.04453	0.06146			0.06104	0.03188	0.16918	0.013										

Source: Actual figures are from the Bureau of Treasury

TABLE 6. OVERALL BOUYANCY COEFFICIENTS OF MAJOR TAX GROUPS 1976 - 1996				
	1976-1986	1987-1996	1987-1992	1993-1996
TOTAL TAX REVENUE	0.93	1.31	1.41	1.15
Individual Income Tax	0.62a/	1.62	1.67	1.53
Corporate Income Tax	0.90a/	1.6	1.57	1.67
Sales Tax/VAT and Licens	0.95	1.52	1.43	1.67
Excise Taxes	1.22	0.8	0.6	1.14
Import Duties	0.71	1.25	1.88	0.29
a/ refers to average for 1980-1986 Source: Estimates by Manasan (1998)				

**TABLE 7. VALUE OF EXPORTS BY COMMODITY GROUP 1/
In Million US Dollars**

Year	Total Exports	Forest Products	Mineral Products	Petroleum Products	Manu- factures 2/	Electronic Equip/ Parts	Garments	Special Transactions	Re-exports
1986	4842	201	539	94	2672	919	751	8	112
		4.15	11.13	1.94	55.18	18.98	15.51	0.17	2.31
1987	5720	243	462	133	3430	1119	1098	7	149
		4.25	8.08	2.33	59.97	19.56	19.2	0.12	2.6
1988	7074	261	764	162	4338	1476	1317	27	80
		3.69	10.8	2.29	61.32	20.87	18.62	0.38	1.13
1989	7821	197	829	95	5192	1751	1575	10	71
		2.52	10.6	1.21	66.39	22.39	20.14	0.13	0.91
1990	8186	94	723	155	5707	1964	1776	19	95
		1.15	8.83	1.89	69.72	23.99	21.7	0.23	1.16
1991	8840	73	610	175	6403	2293	1861	17	82
		0.83	6.9	1.98	72.43	25.94	21.05	0.19	0.93
1992	9824	57	633	150	7298	2753	2140	32	98
		0.58	6.43	1.52	74.15	27.97	21.74	0.33	1
1993	11375	45	686	136	8729	3551	2272	38	165
		0.4	6.03	1.2	76.74	31.22	19.97	0.33	1.45
1994	13483	26	780	132	10615	4996	2375	74	181
		0.19	5.63	0.95	76.68	36.09	17.16	0.53	1.31
1995	17447	38	893	171	13868	7413	2570	108	273
		0.22	5.12	0.98	79.49	42.49	14.73	0.62	1.56
1996	20534	42	772	273	17106	9990	2423	157	323
		0.2	3.76	1.33	83.31	48.65	11.8	0.76	1.57
1997	25228	45	764	257	21488	13052	2349	263	512
		0.18	3.03	1.02	85.18	51.74	9.31	1.04	2.03

1/ Shares to total in italics

2/ Breakdown of major Manufactures (Garments and Electronic Parts/Equip) follow

Source of basic data: BSP, Selected Philippine Economic Indicators

TABLE 8. PRODUCTION STRUCTURE OF THE ECONOMY
Percent Distribution - In real terms

INDUSTRY	1975	1980	1983	1985	1988	1990	1993	1996	1997
1. AGRI.FISHERY,FORESTRY	24.74	23.55	22.04	25.28	23.80	22.19	22.37	20.21	19.62
a. Agriculture industry	21.06	20.54	20.00	23.66	22.07	21.18	21.90	20.10	19.54
b. Forestry	3.68	3.00	2.05	1.62	1.73	1.01	0.47	0.10	0.08
2. INDUSTRY SECTOR	38.48	40.59	41.01	36.06	35.56	35.28	33.67	34.30	34.27
a. Mining & Quarrying	1.27	1.50	1.41	2.14	1.79	1.53	1.55	1.19	1.09
b. Manufacturing	28.39	27.65	26.49	25.87	25.95	25.39	24.27	24.34	23.91
c. Construction	7.01	9.41	10.70	5.22	5.09	5.78	5.13	5.60	6.15
d. Elect,Gas and Water	1.82	2.04	2.41	2.84	2.73	2.58	2.71	3.18	3.12
3. SERVICE SECTOR	37.04	36.05	38.44	41.50	41.56	42.02	42.26	41.56	41.63
a. Trans., Comm. & Stor.	4.77	4.79	4.97	5.69	5.81	5.67	5.75	5.77	5.88
b. Trade	12.55	13.04	13.68	14.90	14.59	14.83	15.06	14.77	14.54
c. Finance	3.36	3.94	3.80	3.08	3.65	4.14	4.00	4.37	4.64
d. O. Dwellings & R. Estate	6.49	5.20	5.29	5.78	5.62	5.54	5.53	5.17	5.07
e. Private Services	5.18	4.91	6.45	7.04	6.94	6.81	6.83	6.61	6.56
f. Government Services	4.69	4.17	4.24	5.02	4.95	5.03	5.10	4.87	4.94
GROSS DOMESTIC PRODUCT	100.26	100.19	101.49	102.84	100.92	99.49	98.29	96.06	95.53
Net factor income from abroad	-0.26	-0.19	-1.49	-2.84	-0.92	0.51	1.71	3.94	4.47
GROSS NATIONAL PRODUCT	100	100	100	100	100	100	100	100	100

Source: The National Accounts of the Philippines, NSO

**TABLE 9. GROWTH RATE
FOR THE MANUFACTURING SECTOR**
Quarter Data: 1994 - 1998

94Q4	6.5	95Q4	6.04
95Q1	6.63	96Q1	4.9
95Q2	8.26	96Q2	6.23
95Q3	6.36	96Q3	6.34
95Q4	6.04	96Q4	4.9
96Q1	4.9	97Q1	2.33
96Q2	6.23	97Q2	5.33
96Q3	6.34	97Q3	4.34
96Q4	4.9	97Q4	3.8
97Q1	2.33	98Q1	1.3

Source: National Income Accounts, NSCB

TABLE 10. SECTORAL GROWTH IN GROSS DOMESTIC PRODUCT
Annual Data: 1991 - 1998

	1991	1992	1993	1994	1995	1996	1997	1998*
Gross Domestic Product	-0.63	0.38	2.10	4.38	4.78	5.80	5.20	0.23
Agriculture, Fishery, and Forestry	0.98	0.10	2.00	3.35	0.83	4.28	2.80	-6.13
Industry	-2.73	-0.28	1.58	5.75	6.98	6.20	6.18	-0.10
Construction	-15.93	6.08	5.73	9.35	6.60	10.88	16.38	-7.27
Manufacturing	-0.48	-1.65	0.68	5.00	6.83	5.58	4.15	0.67
Food manufactures	-1.54	-2.86	-1.55	5.47	2.78	6.58	0.76	2.87
Beverage industries	0.77	-2.30	-6.66	6.05	6.05	7.79	8.54	-0.18
Tobacco manufactures	-1.41	1.35	-3.61	3.77	-0.73	8.01	5.86	-2.89
Textile manufactures	-2.92	-12.02	-0.73	-7.39	6.33	-2.01	-3.24	-6.28
Footwear and wearing app.	6.99	0.60	7.07	5.49	8.11	-8.83	2.66	5.24
Wood and cork prod.	-3.62	-17.91	6.68	-19.42	2.48	-3.67	6.72	-10.87
Furniture and fixtures	-5.21	-11.20	-3.79	6.87	11.28	1.98	11.76	15.56
Paper and paper prod.	0.83	-11.65	-8.40	4.27	19.36	-2.53	-5.52	6.07
Publishing and printing	-0.17	-0.40	-6.24	4.59	6.25	1.27	3.82	8.70
Leather and leather prod.	6.76	-5.70	-2.68	1.38	14.97	13.02	12.57	9.40
Rubber products	0.46	-5.37	-13.70	-4.15	11.78	-8.16	-8.22	-11.49
Chemical & chemical prod.	5.79	-8.31	3.27	1.32	8.06	5.78	7.27	-9.62
Petroleum and coal prod.	-3.77	11.55	-0.66	4.72	7.76	8.79	1.18	-8.03
Non-metallic mineral prod.	9.93	-5.72	9.83	10.71	14.14	7.51	12.57	-6.93
Basic metal industries	0.88	-20.81	7.21	3.89	26.80	-3.91	-1.55	-4.18
Metal industries	-7.41	4.99	1.57	-1.07	4.99	10.77	-4.35	-7.43
Machinery exc. Electrical	-0.14	5.02	4.05	7.00	17.29	15.30	13.51	0.34
Electrical machinery	3.35	2.97	14.95	22.69	13.47	14.74	31.10	14.65
Transport equipment	-7.90	15.18	21.83	7.76	16.55	1.45	-11.08	-30.39
Misc. manufactures	6.16	-19.22	8.86	13.26	2.17	6.40	13.16	14.36
Service Sector	4.90	0.18	1.00	2.48	4.25	5.00	6.40	5.50
Transport Communication and Storage	2.20	0.45	1.40	2.53	4.23	5.80	7.40	8.23
Trade	4.58	0.58	1.63	2.43	3.95	5.55	5.53	4.00
Finance	10.08	-2.65	0.35	2.38	5.45	7.33	13.73	13.03
Ownership of Dwellings and Real Estate	2.75	0.25	0.73	1.80	2.90	3.05	4.15	3.80
Private Services	3.85	-0.18	0.60	2.88	4.28	4.33	4.98	4.85
Government Services	9.00	1.53	0.23	2.85	5.53	3.75	5.93	2.90

* 1st - 3rd quarter 1998 except for breakdown of manufacturing sector (1st half 1998 only)

TABLE 11. ESTABLISHMENTS RESORTING TO CLOSURE / RETRENCHMENT DUE TO ECONOMIC REASONS AND WORKERS AFFECTED

**January 1 to September 30, 1998 (Actual and Expected/Planned)
(Preliminary)**

Region	Number of Establishments			Number of Workers Affected		
	Total ^a	Actual	Planned*	Total	Actual	Planned*
Philippines	2,402	2,276	190	120,359	115,478	4,881
National Capital Region	1,450	1,337	174	69,318	64,652	4,666
Cordillera Administrative Region	12	12	0	555	555	0
Region I- Ilocos Region	30	30	0	447	447	0
Region II -Cagayan Valley	18	18	0	270	270	0
Region III - Central Luzon	134	128	9	15,289	15,110	179
Region IV - S. Tagalog	132	132	0	10,826	10,826	0
Region V - Bicol Region	20	20	0	771	771	0
Region VI - W. Visayas	152	148	4	3,598	3,590	8
Region VII - C. Visayas	198	198	0	10,142	10,142	0
Region VIII - E. Visayas	28	26	2	236	222	14
Region IX - W. Mindanao	18	18	0	1,961	1,961	0
Region X - N. Mindanao	45	45	0	1,877	1,877	0
Region XI - S. Mindanao	136	135	1	3,362	3,348	14
Region XII - C. Mindanao	10	10	0	267	267	0
Caraga	19	19	0	1,440	1,440	0

^a *Details (actual and planned) may not add up to total due to multiple reporting.*

**Expected/planned retrenchment of workers for October, November and December.*

Source: Bureau of Labor and Employment Statistics

**TABLE 12. TOP 1000 CORPORATIONS IN THE PHILIPPINES
DEBT - EQUITY RATIO
TOTAL / AVERAGE BY SECTOR**

SECTOR		1996	1997
1	Agriculture, Hunting and Forestry	1.6404	1.7116
2	Fishing	2.4864	3.2378
3	Mining and Quarrying	0.4409	0.7239
4	Manufacturing	1.2381	1.6124
5	Electricity, Gas and Water	2.3791	3.1262
6	Construction	1.7279	2.2961
7	Wholesale and Retail Trade	2.2953	2.7589
8	Hotels and Restaurants	0.7628	1.0447
9	Transport, Storage and Communication	1.7208	2.8850
10	Financial Intermediation	2.7735	2.9234
11	Real Estate, Renting and Business Activities	0.7065	0.8708
12	Public Administration and Defense; Compulsory Social Security	0.2827	0.1898
13	Education	0.3435	0.2408
14	Health and Social Work	0.6025	0.7071
15	Other Community, Social and Personal Service Activities	0.8429	1.1038

Source: BusinessWorld Top 1000 Corporations 1997-98

TABLE 13. GROWTH OF CREDIT OF THE BANKING SYSTEM

Annual Data: 1980 - 1998

Levels in Billion Pesos; Share in percent

Y E A R	KBs*	Share	T o t a l TBs	Share	L o a n s RBs	Share	Total	Growth Rate	Domestic Liquidity Amount	Growth Rate
1990	270.76	89.10	23.38	7.69	9.74	3.20	303.87	28.07637	300.54	18.36
1991	306.17	88.63	28.52	8.26	10.74	3.11	345.44	13.67705	347.08	15.49
1992	366.81	88.58	34.64	8.36	12.67	3.06	414.12	19.88276	385.39	11.04
1993	506.43	89.31	45.06	7.95	15.54	2.74	567.02	36.92362	480.02	24.55
1994	637.18	88.25	65.69	9.10	19.14	2.65	722.00	27.33182	607.61	26.58
1995	866.33	88.37	89.16	9.09	24.88	2.54	980.36	35.7837	761.43	25.32
1996	1,221.76	88.71	122.11	8.87	33.40	2.43	1,377.27	40.48631	881.4	15.76
1997										
Mar	1,284.59	88.50	132.58	9.13	34.32	2.36	1,451.49		901.79	17.25
Jun	1,418.95	88.59	145.81	9.10	36.90	2.30	1,601.66		923.61	18.92
Sep	1,499.25	88.89	147.99	8.77	39.35	2.33	1,686.58		987.68	23.53
Dec	1,573.15	89.79	139.61	7.97	40.80	2.33	1,752.12	27.22	1,066.02	20.95
1998										
Mar p	1,517.63	89.82	131.16	7.76	40.80	1/ 2.42	1,689.60	16.40	1057.42	17.26
Apr p	1,528.55	89.85	131.78	7.75	40.80	1/ 2.40	1,701.13		1065.31 2/	18.04 4/
May p	1,517.64	89.72	133.15	7.87	40.80	1/ 2.41	1,691.60		1063.60 3/	16.51 5/
Jun p	1,595.37	90.06	135.20	7.63	40.80	1/ 2.30	1,771.38	10.60		

* Inclusive of Specialized Government Banks

1 As of end December 1997

2 Partial figure as of July 1998

3 Partial figure as of August 1998

4 Growth rate: Apr 1997 - Apr 1998

5 Growth rate: May 1997 - May 1998

Source: Bangko Sentral ng Pilipinas

TABLE 14. TREASURY BILL AUCTION RESULTS
From July to latest available
Volume in Million Pesos

D a t e			91 - day				182 - day				364 - day			
			Volume			Rate	Volume			Rate	Volume			Rate
			Tendered	Accepted	Rejected		Tendered	Accepted	Rejected		Tendered	Accepted	Rejected	
J u l y	wk 1	6-Jul-98	3,156	1,311	1,845	14.921	7,845	1,820	6,025	17.198	12,280	1,620	10,660	18.585
	wk 2	13-Jul-98	3,750	1,500	2,250	14.756	12,220	2,000	10,220	16.302	10,560	2,000	8,560	17.344
	wk 3	20-Jul-98	3,530	1,500	2,030	14.193	8,640	2,000	6,640	15.495	5,265	2,000	3,265	16.837
	wk 4	27-Jul-98	2,350	635	1,715	14.189	5,105	2,000	3,105	15.296	5,415	800	4,615	16.830
A u g u s t	wk 1	3-Aug-98	2,225	810	1,415	14.178	2,180	160	2,020	15.240	2,360	250	2,110	16.829
	wk 2	10-Aug-98	1,180				1,465				1,800			
	wk 3	17-Aug-98	3,217	1,500	1,717	14.140	3,785	1,500	2,285	15.194	3,165	2,000	1,165	16.827
	wk 4	24-Aug-98	3,822	1,500	2,322	13.979	4,414	1,500	2,914	14.924	3,446	2,000	1,446	16.751
	wk 5	31-Aug-98	2,475	1,500	975	13.908	2,320	1,500	820	14.965	3,075	2,000	1,075	16.769
S e p t e m b e r	wk 1	7-Sep-98	3,415	1,500	1,915	13.844	3,250	1,500	1,750	14.790	4,510	2,000	2,510	16.534
	wk 2	14-Sep-98	2,525	1,500	1,025	13.754	1,980	1,300	680	14.788	3,935	2,000	1,935	16.434
	wk 3	21-Sep-98	2,275	742	1,533	13.754	1,840	130	1,710	14.785	2,480	550	1,930	16.433
	wk 4	28-Sep-98	750	380	370	13.795	1,640	920	720	14.941	1,690	590	1,100	16.599
O c t o b e r	wk 1	5-Oct-98	4,805	750	4,055	13.793	1,804				3,949	1,776	2,173	16.599
	wk 2	12-Oct-98	4,225	1,500	2,725	13.489	2,513	1,500	1,013	14.759	8,496	2,000	6,496	15.826
	wk 3	19-Oct-98	2,285	1,500	785	13.489	3,079	1,500	1,579	14.615	5,610	2,000	3,610	15.522
	wk 4	26-Oct-98	1,785	1,500	285	13.475	4,459	1,500	2,959	14.442	7,850	2,000	5,850	15.136
N o v e m b e r	wk 1	2-Nov-98	1,780	800	980	13.474	5,165	920	4,245	14.439	5,350		5,350	15.136
	wk 2	9-Nov-98	815	420	395	13.509	4,465	2,000	2,465	14.271	5,391	2,000	3,391	15.075
	wk 3	16-Nov-98	2,505	1,500	1,005	13.473	3,725	2,000	1,725	14.188	5,939	2,000	3,939	14.853
	wk 4	23-Nov-98	2,505	1,500	1,005	13.401	1,845	1,845	0	14.096	7,153	2,000	5,153	14.344
	wk 5	30-Nov-98	2,389	1,500	889	13.402	5,275	2,000	3,275		4,500	2,000	2,500	14.273
D e c e m b e r	wk 1	7-Dec-98	3,230	650	2,580	13.405	2,680				3,684			
	wk 2	14-Dec-98	1,610	300	1,310	13.406	1,851	500	1,351	13.863	3,100	505	2,595	14.270

Source: Bureau of Treasury; BusinessWorld

**TABLE 15. NON - PERFORMING LOANS, TOTAL LOANS
AND LOAN LOSS PROVISIONS OF THE BANKING SYSTEM**
Annual Data: 1 9 8 0 - Latest available
Ratios in Percent

Y E A R	NPL / Total Loans				Loan Loss Prov. / Total Loan			
	KBs*	TBs	RBs	Total	KBs*	TBs	RBs	Total
1980	10.966	5.623	26.976	11.288	2.062	0.168	1.783	1.950
1981	13.440	16.530	26.290	14.106	0.933	0.358	2.516	0.964
1982	15.352	7.281	20.204	15.203	1.270	0.475	1.954	1.265
1983	12.072	7.961	22.215	12.232	1.327	0.472	2.301	1.319
1984	21.013	15.070	36.272	21.245	2.537	0.667	2.905	2.465
1985	22.637	15.478	42.752	23.057	3.452	1.137	3.315	3.345
1986	20.442	14.358	41.811	20.879	22.228	1.115	3.638	20.591
1987	13.714	9.895	37.295	14.492	8.035	0.837	3.990	7.308
1988	10.797	8.030	34.906	11.618	5.966	0.854	4.078	5.483
1989	8.236	6.684	31.239	8.941	5.424	0.691	4.181	4.968
1990	7.175	7.238	28.502	7.863	4.683	1.403	4.252	4.417
1991	6.612	7.605	26.331	7.308	4.008	1.792	4.160	3.829
1992	6.132	7.870	24.426	6.837	3.395	1.724	3.765	3.266
1993	4.708	6.017	21.327	5.267	2.628	1.365	3.281	2.546
1994	3.931	8.359	18.166	4.711	1.883	3.077	3.219	2.027
1995	3.233	7.894	16.068	3.983	1.591	2.665	2.758	1.718
1996	2.799	7.741	14.139	3.513	1.240	2.685	2.036	1.387
1997								
Mar	3.294	7.434	14.858	3.946	1.319	2.271	2.022	1.422
Jun	3.373	7.742	14.633	4.030	1.305	2.106	1.941	1.393
Sep	3.962	10.091	14.950	4.756	1.435	2.166	1.847	1.509
Dec	4.688	10.633	16.177	5.433	2.211	3.119	1.953	2.275
1998								
Mar	7.420	14.321	16.177	8.167	2.590	3.564	1.953	2.651
Apr	8.595	16.263	16.177	9.371	2.678	3.658	1.953	2.737
May	9.441	16.090	16.177	10.127	2.744	3.492	1.953	2.784
June	8.947	16.760	16.177	9.710	2.744	3.949	1.953	2.818

Source: Bangko Sentral ng Pilipinas

TABLE 16. STRUCTURE OF LOANS OF THE COMMERCIAL BANKING SYSTEM
In Million Pesos

	1990	1991	1992	1993	1994	1995	1996	1997	April 1998
1. Total Loans, Net 1/	215,631.9	230,783.6	278,040.3	376,176.7	483,937.9	678,680.0	1,117,966.3	1,400,081.7	1,378,635.3
% of Total Assets 2/	42.0	41.6	44.5	48.7	49.6	53.3	58.1	54.6	55.6
2. Restructured Loans, Net	4,266.0	4,920.5	8,433.6	9,252.7	8,386.5	5,289.1	13,258.0	14,271.4	15,624.7
% of Total Loans	2.0	2.1	3.0	2.5	1.7	0.8	1.2	1.0	1.1
3. ROPOA, Net	2,992.2	3,323.0	4,317.5	7,860.5	8,913.1	8,762.1	10,898.4	18,406.9	23,019.0
% of Total Loans	1.4	1.4	1.6	2.1	1.8	1.3	1.0	1.3	1.7
4. FCDU Loans (M US \$)	879.0	741.0	1,697.0	2,344.0	3,478.0	5,323.0	10,811.0	10,547.0	9,317.0
% of Total FCDU Assets	20.5	16.4	29.4	33.0	35.6	43.2	54.7	46.3	45.8

Notes:

1 Excluding Interbank Loans

2 1994,1997 and 1998 were based on unadjusted total assets

Source: Bangko Sentral ng Pilipinas

**TABLE 17. COMMERCIAL BANKS' LOANS OUTSTANDING TO THE REAL ESTATE SECTOR
BY PURPOSE**

As of dates indicated

Amount in million pesos; Share in percent

	1 9 9 7						1 9 9 8			
	Jun	Share	Sept	Share	Dec	Share	Mar	Share	Jun	Share
Total Loans Outstanding (CSOC) 1/	1267180.8		1354011.6		1405521.0		1367483.0		1402470.4	
Purpose of Loans to the Industry										
Acquisition of Residential Property	34980.9	21.9	30645.4	16.5	32447.5	15.9	32179.4	16.5	33226.2	17.5
Land	6904.5	4.3	4705.2	2.5	6952.6	3.4	6354.5	3.2	6826.6	3.6
Individual Units	21901.6	13.7	25940.3	14.0	25494.9	12.5	25824.9	13.2	26399.6	13.9
Acquisition of Commercial Property	17644.4	11.0	16470.5	8.9	18685.5	9.2	17510.9	9.0	16869.8	8.9
Development of Subd. For Housing	26629.1	16.7	42755.3	23.1	45519.1	22.4	46420.5	23.7	36945.5	19.4
Development of Industrial Park	2774.9	1.7	4177.0	2.3	5947.8	2.9	5879.1	3.0	4977.5	2.6
Development of Commercial Property	26096.8	16.3	27308.0	14.7	30166.4	14.8	27857.7	14.2	28123.9	14.8
Dev. Of Recreational & Amusement Park	4060.2	2.5	4338.0	2.3	3814.6	1.9	3643.8	1.9	4040.5	2.1
Development of Memorial Park	823.0	0.5	922.5	0.5	1020.0	0.5	910.2	0.5	862.2	0.5
Construction of Office Condominium	6958.9	4.4	9839.4	5.3	9629.6	4.7	10276.6	5.3	11728.3	6.2
Const. Of Residential Condominium	9758.7	6.1	11782.1	6.4	14073.0	6.9	15008.7	7.7	12626.2	6.6
Construction of Infrastructure Project	3373.2	2.1	4761.1	2.6	5175.2	2.5	5009.4	2.6	7110.1	3.7
Other Purposes	26774.0	16.7	32453.9	17.5	37054.2	18.2	30857.2	15.8	33882.0	17.8
TOTAL	159874.1	100.0	185453.2	100.0	203532.9	100.0	195553.5	100.0	190392.2	100.0
Ratio of real estate loans to total loans outstanding	12.62		13.70		14.48		14.30		13.58	

1 Exclude interbank loan receivables, banks without real estate transactions and real estate loans of Banks' trust departments.

Source: Bangko Sentral ng Pilipinas

TABLE 18. TREATMENT OF PAST DUE LOANS			
Mode of Payment	Installment in Arrears		
	1987	Pre '97	Current
Monthly	10 or more	6	3
Quarterly	4 or more	2	1
Semi - Annually	3 or more	1	1
Annualy	2 or more	1	1
Source: Infonotes, BAP Policy Research Group			

TABLE 19. SCHEDULE OF COMPLIANCE GENERAL LOAN - LOSS PROVISION In Percent of Loan amount

1 October 1998	1.0
1 April 1999	1.5
1 October 1999	2.0

Source: Bangko Sentral ng Pilipinas

TABLE 20. SCHEDULE OF COMPLIANCE ALLOWANCE FOR PROBABLE LOSSES In Percent of Loan amount			
Classification	Existing	12/31/98	4/15/99
Loans especially mentioned	0	2.5	5
Substandard			
Collateralized	0	12.5	25
Uncollateralized	25	25	25
Doubtful	50	50	50
Loss	100	100	100
Source: Bangko Sentral ng Pilipinas			

TABLE 21. MINIMUM CAPITAL REQUIREMENT
In Million Pesos

	Existing Requirement	Compliance Period		
		12/24/98	12/31/99	12/31/2000
Expanded Commercial Banks	3,500	4,500	4,950	5,400
Commercial Banks	1,625	2,000	2,400	2,800
Thrift Banks				
Within Metro Manila	200	250	325	400
Outside Metro Manila	40	40	52	64
Rural Banks				
Within Metro Manila 1/	20	20	26	32
Cities of Cebu and Davao 1./	10	10	13	16
1st/2nd/3rd class cities & 1st				
class municipalities	5	5	6.5	8
4th/5th/6th class cities &				
2nd/3rd/4th class municipalities	3	3	3.9	4.8
5th/6th class municipalities	2	2	2.6	3.2

Note:

1 For existing banks only. No new banks are presently allowed.

Source: Bangko Sentral ng Pilipinas

TABLE 22. SELECTED BALANCE SHEET ACCOUNTS
COMMERCIAL BANKS
Third Quarter 1998
In Billion Pesos

	Assets	Capital Accounts
Expanded Commercial Banks (EKBs)		
Domestic Banks		
1 Allied Banking Corporation	88.663	8.983
2 AsianBank Corporation	33.496	3.765
3 Banco de Oro Universal Bank	33.407	3.987
4 Bank of the Philippine Islands	212.388	27.688
5 China Banking Corporation	59.822	9.934
6 Development Bank of the Philippines	110.125	13.927
7 Equitable Banking Corporation	107.428	15.763
8 Far East Bank & Trust Company	140.393	18.738
9 Land Bank of the Philippines	170.939	15.184
10 Metropolitan Bank & Trust Company	269.661	41.208
11 Philippine Bank of Communications	32.648	4.230
12 Phil. Commercial International Bank	145.448	23.407
13 Philippine National Bank	225.080	23.075
14 Prudential Bank	26.696	3.193
15 Rizal Commercial Banking Corp.	115.672	12.153
16 Security Bank Corporation	52.900	7.222
17 Solidbank Corporation	53.370	5.497
18 Union Bank of the Philippines	40.021	9.622
19 United Coconut Planters Bank	111.647	14.072
20 Urban Bank, Incorporated	11.667	2.501
Branch of a Foreign Bank		
1 ING Bank N.V.	91.399	0.894

	Assets	Capital Accounts
Non - Expanded Commercial Banks (NEKBs)		
Domestic Banks		
1 Al-Amanah Islamic Inv't. Bank of the Phils.		
2 Asia United Bank Corporation	2.585	1.746
3 Bank of Commerce	11.960	2.002
4 Bank of Southeast Asia, Incorporated		
5 East West Banking Corporation	9.279	1.689
6 Export & Industry Bank	5.196	1.692
7 Global Business Bank	5.606	2.240
8 International Exchange Bank	27.416	3.169
9 Orient Commercial Banking Corporation		
10 Philippine Banking Corporation	16.004	1.975
11 Philippine Trust Company	20.006	2.436
12 Philippine Veterans Bank	14.915	3.704
13 Pilipinas Bank	13.493	1.756
14 TA Bank of the Philippines	2.133	1.391
15 Traders Royal Bank	11.680	1.425
16 Westmont Bank	20.771	1.937
Subsidiaries of Foreign Banks		
1 Banco Santander Philippines, Incorporated	6.751	1.729
2 Chinatrust (Phils.) Commercial Bank Corp.	6.874	1.827
3 Dao Heng Bank, Incorporated	5.172	1.789
4 Maybank Philippines, Incorporated	5.470	1.635
Branches of Foreign Banks		
1 ANZ Banking Group, Ltd.	10.161	0.250
2 Bangkok Bank Public Co., Ltd.	4.016	0.266
3 Bank of America, NT & SA	11.411	0.210
4 Citibank, N.A.	147.802	2.547
5 Deutsche Bank AG	14.833	0.625
6 Hongkong & Shanghai Banking Corporation	43.377	1.000
7 Korea Exchange Bank	6.082	0.257
8 Standard Chartered Bank	29.487	0.900
9 The Bank of Tokyo-Mitsubishi, Ltd.	19.196	0.720
10 The Chase Manhattan Bank	13.320	0.217
11 The Development Bank of Singapore	14.146	2.139
12 The Fuji Bank, Ltd.	9.077	0.202
13 The International Commercial Bank of China	10.434	0.440
Source: BusinessWorld, November 18, 1998		

TABLE 23. NUMBER OF TARIFF LINES AFFECTED BY EO 465			
	1998	1999	2000
Increase in tariff	990	466	694
Decrease in tariff	287	485	718
Same rate as set under EO 264	589	915	454
Total	1866	1866	1866
Source: Tariff Commission			

TABLE 24. AVERAGE NOMINAL TARIFF RATES**By Sector****1998 - 2000****In percent**

Sector	1998	1999	2000
Pre EO 465			
Overall	10.74	10.28	9.00
Agriculture, Fishery and Forestry	20.70	19.01	18.06
Mining	3.91	3.91	3.13
Manufacturing	9.05	8.82	7.45
EO 465			
Overall	11.24	10.21	9.08
Agriculture, Fishery and Forestry	19.82	17.96	16.56
Mining	3.89	3.84	3.21
Manufacturing	9.87	8.97	7.88

Source: Tariff Commission

TABLE 25. ESTIMATED AVERAGE EPR**By Sector****1998 - 2000****In percent**

Sector	1998	1999	2000
Pre EO 465			
Overall	19.27	18.01	17.38
Agriculture, Fishery and Forestry	17.35	16.96	16.55
Mining	0.50	0.53	0.25
Manufacturing	21.25	19.44	18.73
EO 465			
Overall	14.10	13.24	12.48
Agriculture, Fishery and Forestry	12.64	12.36	11.72
Mining	0.55	0.58	(0.07)
Manufacturing	15.48	14.34	13.52

Source: Tariff Commission

