Cory and the Creditors

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In its obituary on President Corazon Aquino, the *Economist* asserts that she attained greatness in leading the fight to oust the dictator Ferdinand Marcos but disappointed when it came to governing. "Her greatest achievement," says the magazine, "was to survive seven attempted coups and hand over [power] peacefully at the end of her six-year term."

Among the key reasons it cites was Cory's failure to "break the grip of the aristocrats" through land reform. It is not surprising, however, that this pro-business magazine fails to mention an equally, if not more decisive reason for the dismal economic record of her administration: the priority that it gave to repaying the massive $26 billion it inherited from Marcos.

A few months before she came to power, the University of the Philippines School of Economics, in its famous *White Paper*, had warned: "The search for a recovery program that is consistent with a debt repayment schedule determined by our creditors is a futile one and should therefore be abandoned." The issue of debt repayment shot to the forefront soon after her assumption of office in early 1986. Without even giving it breathing space, the International Monetary Fund (IMF) and the World Bank, at the urging of the country's commercial creditors, put debt servicing at the top of the new administration's agenda. Fairly quickly, Aquino faced the choice of devoting the country's scarce financial resources to development or to debt repayment.

Within the government, the first position was espoused by Professor Solita Monsod, then director of the National Economic Development Authority (NEDA). Opposing her was Central Bank Governor Jose "Jobo" Fernandez, a Marcos holdover, who warned of the risk of "economic retaliation against the country" should it take unilateral actions in defiance of its creditors. Trade credit lines could be withheld, paralyzing foreign trade, and foreign aid could be suspended. According to one account, Citibank president John Reed visited the Philippines and warned that unilateral action on debt "would produce immense suffering and difficulty for the people."

The so-called "model debtor strategy" won out, partly because its opponents within the government did not put up more than token opposition. This was a mistake, according to economist Jim Boyce, because the "credibility of these threats is open to question." In any event, President Aquino issued Proclamation 50, which committed the government to honoring the original terms of the Philippines' enormous debt, including odious ones like those contracted to build the Bataan Nuclear Power Plant. The model debtor approach was institutionalized with Executive Order 292, which affirmed the "automatic appropriation" of the full amount to service the debt coming due each year from the budget of the national government that was originally mandated by Marcos' Presidential Decree 1177.

In the critical period 1986 to 1993, an amount coming to some 8 to 10 percent of the Philippines GDP left the country yearly in debt-service payments, adding up to a total of nearly $30 billion – an appalling sum, especially considering that the Philippines' total external debt in 1986 was only $21.5 billion. Furthermore, the onerous repayment terms, subject to variable interest rates, forced the government to adopt the practice of incurring new debt to pay off the old, so that instead of showing a reduction, the foreign debt by 1993 had gone up to $29 billion.

Gutting government investment

Interest payments as a percentage of total government expenditure went from 7 percent in 1980 to 28 percent in 1994. Capital expenditures, on the other hand, plunged from 26 to 16 percent. Debt servicing, in short, became, alongside wages and salaries, the number one priority of the national budget, with capital expenditures being starved of outlays. Since government is the biggest investor in the Philippines—indeed, in any country—the radical stripping away of capital expenditures goes a long way toward explaining the stagnant 1 percent average yearly GDP growth rate in the 1980s and the 2.3 percent rate in the first half of the 1990s.

The radical reduction of government spending so that resources could be channeled to debt service was consistent with the policies of IMF- and World Bank-backed structural adjustment that the Aquino administration inherited from the Marcos regime. Instead of encouraging private investment to step into the breach created by the retreat of government investment, as predicted by free-market ideology, the latter discouraged or "crowded out" private investment. This was especially clear when it came to Japanese investment, which was the main factor behind the explosive growth of our neighboring economies in the late eighties and early nineties. While Japanese capital flowed in large volumes to our neighboring economies during the great explosion of Japanese investment in Southeast Asia in 1985-1995 owing to "endaka" or the revaluation of the yen, it bypassed the Philippines, which was wallowing in stagnation owing to the double punch of structural adjustment and debt repayment. Japanese investors were not about to pour their money into a depressed economy that contained no promise of profits.

It is estimated that between 1987 and 1991, the Philippines received a paltry amount of $797 million in Japanese investment, Thailand received $12 billion. Including investment from Taiwan and Hong Kong that followed in the Japanese wake, the difference was even more marked: Thailand received $24 billion in investment during the same period, or 15 times the amount invested in the Philippines, which came to $1.6 billion. "This difference in the flow of foreign investment from the three countries," economist Kunio Yoshihara noted, "produced a significant disparity in growth performance of the two countries during the period." Indeed, it was during the Aquino presidency that the Philippine economy was definitively left behind by our neighbors, who were registering impressive 6-10 per cent growth rates per annum while we barely inched forward.

The road not taken

Had the Aquino administration displayed more spine, a scenario like that which transpired in Argentina earlier this decade was not out of the question. With his country bankrupted by massive debt repayments, newly elected President Nestor Kirchner told Argentina's creditors in 2002 that he was going to pay only 25 cents for every dollar that Argentina owed foreign bondholders. When the bondholders protested, Kirchner told them they had better take the offer or he would lower his offer to 10 cents for every dollar. The bondholders capitulated. The outcome: owing to the channeling into domestic investment of the financial resources which would have otherwise hemorrhaged as debt repayments, Argentina grew by an average of 10 per cent between 2003 and 2008.

Political will spelled prosperity in Argentina. Lack of it during the Aquino administration condemned the Philippines to stagnation.

Cory Aquino was instinctively a democrat, which is the reason she was so determined in her battle to bring back democracy to the Philippines. But she was also instinctively a conservative when it came to economic matters such as land reform and foreign debt policy. Glorious figures are also often tragic figures. And the tragedy of Cory Aquino is that the democratic institutions she restored or established are now threatened by the troubled legacy of her conservative and failed economic policies.

P.S.

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