

Till Debt Do Us Part: A Failed Marriage

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Our negotiating failure

Last year, the Philippines negotiated for a new rescheduling agreement with our commercial bank creditors. No other debtor country with as much foreign debt had undertaken as fundamental and as wide-ranging structural reforms as we had. We were also current on all our interest payments and were in compliance with an IMF stabilization program. Under the Baker Plan, such exemplary behavior should have been rewarded with favorable treatment from commercial banks. Just the year before, we had thrown out the dictatorship that had taken out the loans and had stolen the money. Then we came to the negotiating table generously expressing a willingness to pay every penny. Yet the agreement we signed in July 1987 gave us much less than the banks had given Mexico and were just about to give Argentina, and much less

than the banks are now in the process of giving Brazil.

Structural reform

It is very difficult to understand this turn of events. In the last two years, the Philippine economy has begun to recover from the deep depression brought on by the economic and financial crisis of late 1983. The economy has taken off and is on the path of sustainable growth. Inflation had been kept down and balance of payments problems avoided. Wide-ranging structural reforms were introduced to reduce government intervention in economic decision making, reestablish competitive markets and promote a more outward-looking economy.

There is no doubt that significant progress has been made in attaining the ambitious goals the Aquino administration set down two years ago. Government has sold off P6.5 billion of its corporations and assets to the private sector. It reestablished competition in vital agricultural markets, thereby adding billions of pesos a year to the income of coconut, sugar,

rice and corn farmers. It rehabilitated its major financial institutions and set them on the road towards efficiency and viability. It resumed its painful liberalization program to build efficient industries to compete with the best in the world. It restructured its fiscal sector through reforms in the tax system, decentralization of the budgetary process, and resetting of budgetary priorities in favor of redistributive programs like basic education, primary health care, agrarian reform, and rural development.

But these economic structural reforms pale in comparison with what we, as a people, have done on the political front. We toppled a dictatorship and, with speed and care, restored democracy.

Yet, even with these remarkable achievements, we continue to suffer shabby treatment from our bank creditors.

Why we got a bad deal from the banks

What did Argentina, Brazil and Mexico have that we didn't have? Not only did Argentina and Mexico get easier payment terms in interest spreads and loan maturities, but most importantly, they also got new financing from banks (\$7.7 billion for Mexico and \$1.95 billion for Argentina). We got no such financing because we did not even ask for it. More recently, Brazil has negotiated a new agreement, not having paid interest since February and having banned the IMF from the country for years. Brazil will pay the same interest spread that Argentina and Mexico are paying -- 13/16% over Libor instead of the 14/16% over Libor we are paying -- and will get \$5.2 billion in new money. For its mischief, Brazil is getting a better deal than we got.

What these countries had that we seemed to lack were tough and competent negotiating teams. Our own team would come to the negotiating table having already surrendered the only leverage we had -- the threat of not paying. They would focus on gimmicks -- then it was Philippine Investment Notes (PINS), now it is Mexican-type defeasance schemes -- instead of the key issue of reducing our debt-servicing burden and financing economic growth.

The other side would be quick to question our numbers, assumptions, and motives, because across the table they would see the faces of some of the same officials that had justified the excessive borrowing and the fabricated reserve figures under Marcos. In the negotiations, it didn't matter that Mrs. Aquino was now President and the nation was now a democracy. In the end, the Philippine team would simply take the word of the banks that the deal they were giving us was the best deal possible. The banks never had it so good, and no wonder they have been the staunchest supporters of our present negotiating team.

Our debt negotiators have given two reasons for being so accommodating to commercial banks:

(a) The country cannot afford to antagonize the foreign commercial banks. They claim in particular that a "confrontational" stance would result in withdrawal of trade credits.

(b) The country should not use commercial sources since official (e.g., Japan and the United States) and multilateral (e.g., World Bank) loans are quite easy to obtain.

But does asking for relief or new money from the commercial banks constitute a reckless negotiating strategy? And are loans from multilateral and official sources sufficient to make up for our failure to obtain good terms from commercial creditors?

Lessons from Peru

Our negotiators never fail to point to problems of Peru, which has clearly taken a tougher stance than the Philippines. The reasoning is faulty, since it is unclear that Peru's recent economic woes are due to its debt strategy. Neither does it necessarily follow that taking a "tougher" stance means doing as Peru did. Brazil and Mexico did much better than the Philippines in their negotiations with creditors without taking a position as "confrontational" as Peru's or as gutless as the Philippines.

In July 1985, Peru limited its debt service to 10 percent of its export earnings, admittedly a crude strategy but one which seems to have produced better results for them than our strategy produced for us. Before Peru declared a ceiling on debt service in July 1985 its production and imports were shrinking. Imports fell from \$2.2 billion to \$2.0 billion from 1984 to 1985 and in 1985 real output was 6.4% lower than the level in 1982. After the debt service ceiling was imposed, both imports and real output grew impressively. Imports grew to \$2.8 billion in 1986 and \$3.3 billion in 1987. Real GDP grew by 8.6% in 1986 and by 6% in 1987.

These statistics hardly portray a country that is suffering from a withdrawal of credit. While some credit may have been withdrawn, whatever was lost was made up by other sources and by the reduction in Peru's debt-service payments, as is made plain by the 40% growth in imports in 1986. The much feared loss of trade credits never materialized to the extent envisioned by doomsayers. Banks after all are in the business to make money, and trade credits are a safe way to make money, since the credit is secured by goods in shipment. If banks did not cut off Peru, why should they do it to the Philippines simply because the country is playing hardball on the negotiating table?

Lately, Peru has been beset with difficulties despite the fact that it did better than the Philippines on the debt front. Peru's terms of trade

worsened. This, coupled with gross mismanagement of the domestic economy, including the nationalization of local banks, was enough to wipe out much of the breathing spell from the debt ceiling. Peru has many exchange rates which discourage exports, encourage capital flight, and fuel unproductive speculation. In short, Peru's economy probably slowed down despite, not because of its debt policy.

We do not advocate the Peruvian solution at all. Nonetheless, scare stories emanating from friends of our commercial bank creditors should be discounted. We should search for better solutions with a sober understanding of the facts. And it is quite likely that the paths broken by Mexico and Brazil are more promising than the Peruvian way.

Limits of loans from foreign governments and multilaterals

The goodwill of the Aquino government has created expanded opportunities for loans from foreign governments and multilateral institutions like the World Bank and Asian Development Bank. However, the restrictive nature of such loans will make them inadequate to fill the wide gap in our financing needs that servicing our debt to commercial banks would create.

Loans from the World Bank and the Asian Development Bank cannot be rescheduled. Indeed any new loans we can hope to get from them would cover only the foreign exchange we need to pay amortization and interest on our existing loans from these multilateral sources. Moreover, these multilateral agencies are slow to process loans, with gestation periods between proposals and the release of money of up to three years. The money itself would be released only gradually over the life of the project, typically five years.

Loans from such governments as the United States and Japan are so restrictive that it may not even be wise for the country to tap them all. In particular, these loans are often tied to imports from the lending country. The country cannot rely on these sources to meet unanticipated increases in the country's financial needs that are brought about by external shocks or disturbances (e.g., a sharp decline in export prices).

Elements of a new debt strategy

An effective approach to debt negotiations should have the following elements: (a) a focus on net resource flows; (b) a contingent agreement that links net resource flows to economic conditions; (c) a distinction between old debt and new that gives seniority to new loans; and (d) a new negotiating team unencumbered with baggage from the past.

The focus on net resource flows recognizes that the overriding issue is whether the country will get the financing it needs to continue to grow. The best way to get such financing is through some debt relief, so that the country can use more of its export earnings for its own needs rather than for debt service. While no major debtor country has yet obtained this, foreign banks are now in a better position to forgive, having set aside massive amounts of loan loss reserves for LDC debt. If debt cannot be forgiven, then we must have financing in the form of new loans from banks. We need the money now, and we should take it in any form we can get it.

We should also work for an agreement that will take account of economic uncertainties. The prices of our exports may fall, the prices of our imports may rise, a drought or typhoon may devastate our crops, and labor strife may halt industrial production. In any such event, we will need more financing than anticipated. Hence we should build into our agreement with the banks adequate provision for more debt relief or more new money should the need arise.

It is also essential to distinguish between old debt and new debt. If we suddenly find ourselves short of resources to service all our debt, we should service first the loans taken out under the present government before we service the debts of the previous regime. Such seniority of new debt over old is important not only as a matter of moral principle but also because it would help in obtaining new money from banks and in making more workable such debt reduction schemes as debt defeasance and exit bonds.

Finally, we need a fresh negotiating team with enough self respect to stand up to the banks and enough heart to put above everything else the well-being of the Filipino people.

A new negotiating team

In any new negotiation, the Philippines must approach the bargaining table with a team that is free of the burden from the last negotiations and the past regime. In previous encounters, negotiators for the commercial banks have taken the measure of our representatives and have run all over them. To keep the negotiations interesting, we need to face our adversaries with a new team capable of regaining some of the initiative we lost in past negotiations.

The presence of negotiators connected with the past regime is very damaging to our side. The Philippines' strongest argument for a better deal is that it had the courage to throw out the dictator responsible for the mess and that it has taken the bitter medicine to correct the situation it found itself in. Our country, to say the least, has paid its dues in the form of painful belt-tightening and economic restructuring amid political and social strife. It deser-

ves a negotiating team able to make foreign bankers appreciate that they should share in the burden of paying for the sins of the past.

The history of our past negotiations suggest qualities our new negotiations might possess. While our negotiators should be knowledgeable in economics and finance, perhaps it is time to turn to politicians, jurists or academics who are free of any vested interest, rather than local bankers eager to please their foreign counterparts. Our negotiators should be internationally respected, with reputations that do not hang on particular outcomes of the negotiations and who can walk away from the table knowing that their life accomplishments will remain intact. Given the importance of the issue, our negotiators should probably serve full time as negotiators and as managers in charge of dealing with our debt problem. Above all, our negotiators should be steadfast in defending the interests of their country.

What to do with the money

The program outlined here is based on a basic philosophy: the money should be used in productive investment. Since the resource inflow carries a market price, it should be harnessed to increase production either directly or indirectly and must not be used to increase entitlements that require future financing. We believe the following uses meet this criterion.

a) Industrial restructuring

The industrial restructuring program (IRP) started in 1980 is designed to produce an economy that eventually earns the foreign exchange it uses. The three legs of the IRP are tariff reform, trade liberalization and the exchange rate adjustment. Tariff reform and trade liberalization are designed to foster industries that reflect the strengths of our economy. Exchange rate adjustment will enable our industries to compete in the world market. These changes require large amount of financing for imports of machinery and other investments for the industries that will compete in the international market place.

b) Transport and telecommunication infrastructure

We need to upgrade more of our road to "all-weather" types. Farm-to-market roads generate quick and lasting pay-offs, both economically or politically. Our sea and air ports need upgrading. We also

need to put more resources into telecommunications, especially telephones.

c) Power-generating facilities

Standing in the way of efficient industries are high energy costs and unreliable power delivery. We clearly need another 650-megawatt plant to support the Luzon grid and for power to come onstream in five years. The Isabela geothermal site for Northern Luzon and the Bicol geothermal sites should be fully exploited. This would need huge outlays on construction and imported machineries. For distribution, bringing Palimpinon (Negros) power to Cebu industrial users would also require huge outlays for underwater cable.

d) Reforestation

Reforestation is a tremendous undertaking that will pay off handsomely but only after a long time. This may well be the challenge of this generation. There is no question that forest cover will affect a host of more immediate concerns: agricultural productivity, power generation, flood controls, offshore fishing and ecology.

e) Comprehensive Agrarian Reform Program

This is an initiative that government is committed to and belongs to the category of producing a "level playing field" where liberal democracy can thrive. It is very difficult for government to finance all the requirements of CARP in the next five years: acquisition, preparation, and support services. Reduced external debt service would release resources to help address this issue.

f) Water System

There is a need to improve water supply and distribution. This will benefit both industrial and household users. The money could be used to finance the President's commitment to provide clean water to 92 percent of the rural population by 1992, as compared to 62 percent this year.

g) Education

Primary and secondary education which is now "free" must also become substantial. We need additional school buildings, textbooks, libraries, and computers. As we improve the lot of our teachers, we must complement their renewed spirit with modern teaching aids to prepare our children for the 21st century.

