The Mexican Crisis and the Philippine Economy*

Freedom from Debt Coalition

It is true that Mexico's international reserve predicament at the time of its devaluation is exactly the Philippines' converse. While Mexico's reserves plummeted from $30 billion in January 1994 to $6 billion in December of the same year, the Philippine reserve situation reached an unprecedented high during the same period. The Philippine government vehemently denies that parallelisms exist between the two economies. But what is starkly real cannot be denied.

Surely, the Mexico crisis will not create major repercussions on the Philippine economy at the moment. While trading in the Philippine stock market dropped by 150 points early this year[1], the following days saw an onslaught of trading in the exchange, albeit not as agressively as before. Although still below their previous levels, stock prices in the Philippines have since stabilized, boosting the confidence of analysts in the resurgence of the stock market.

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The shock of Mexico's collapse caught the Philippines precisely at its moment of glory, still ecstatic over the 5.5 percent growth achieved in 1994. The crisis is probably an omen of things to come. It signals the need to assess the strength of our economic take-off. For falling flat on our faces is not quite an attractive proposition.

The Mexican Crisis

In the late 1980s, Mexico was experiencing hyperinflation while being swamped by its burgeoning debt payments. By September 1989, the country signed an agreement with commercial banks to reschedule the payment of its debts under the Brady initiative.[2]

Mexico's entry into the North American Free Trade Agreement (NAFTA) in late 1992 revived the slumbering economy. This ushered in a new era in the country's economic development characterized by the liberalization and opening up of its markets. With this strategy, it achieved slight budget surpluses[3] while confining inflation to low levels. The impressive performance of the Mexican economy in 1993 made it one of the more promising emerging markets.[4]

The growth of the Mexican economy was fueled by large infusions of foreign capital. Table 1 shows the significant increase in the amount of international capital Mexico has been able to raise between 1990 and 1993.

Table 1

Funds Raised in the International Capital Market, Mexico (in US$ billion)

Year	Amount
1990	2,350
1991	5,568
1992	3,374
1993	9,751

Source: *Financial Flows and the Developing Countries: A World Bank Quarterly,* August 1994.

"[F]rom 1991 to 1994, merchandise imports as a percentage of GDP has consistently risen, while merchandise exports continued to lag behind....This means that over the four-year period, the trade balance has been deteriorating."

At the outset, Mexican coffers had enough foreign reserves to maintain its exchange rate. More importantly, this period of abundance tolerated the increasing trade and current account deficits. However, while the tip of the mountain was still visible from the plains, signs of imminent danger were ignored. This complacency led Mexico to fall into a deep ravine. The availability of cheap imports continued to widen the trade gap which, in turn, drained the country's international reserves.[5]

Amid pronouncements by government of control over the situation, a devaluation of more than 40 percent of the Mexican peso became the fitting denouement to this success story.

Lessons To Be Learned

The Mexican crisis meant the loss of confidence of foreign investors in the emerging markets. The Philippines itself experienced a one-day decline of 150 points in the stock market as investors frantically pulled out their money. The frenzied buying of dollars occurred as peso-denominated assets spelled mounting risks to foreign investors. As the currency was threatening to devalue beyond the volatility band[6], a two-hour ban was imposed on dollar trading.

There is wisdom to be learned here. Table 2 indicates the increasing proportion of portfolio investments in the Gross Domestic Product (GDP). Note that although direct foreign investments have increased over the past years, portfolio investments still comprise the bulk of foreign capital inflows.

The Philippine economy can very well follow the track of the Mexican economy. At present, the net inflow of dollars seems to compensate for the poor state of the trade deficit.

Table 2

Inflow of Foreign Investments (% of GDP)

	1986	1987	1988	1989	1990	1991	1992	1993	1994
New Foreign Investments	0.06	0.10	0.21	0.22	0.39	0.29	0.44	0.61	2.27
Portfolio Investments	0.04	0.06	0.13	0.91	0.35	0.5	1.07	4.15	4.68

Legend: New Foreign Investments; Portfolio Investments

However, from 1991 to 1994, merchandise imports as a percentage of GDP has consistently risen, while merchandise exports during the same period continued to lag behind, as shown by Table 3. This means that over the four-year period, the trade balance has been deteriorating. Thus, the balance-of-payments (BOP) surplus in the first three quarters of 1994,

Table 3

Trade Balance as a percentage of GDP

	1991	1992	1993	1994
Trade Balance	-7.09	-8.85	-11.44	-14.03
Exports	19.52	18.52	20.91	20.96
Imports	26.61	27.38	32.35	34.98

Source: Bangko Sentral ng Pilipinas and NSCB

which the government has been harping on, only manifests the increasing dependence of the economy on foreign capital.

Emerging Markets in Retrograde

The Mexican situation reflects structural problems which starkly resemble our own. After its emergence from the debt crisis in the 1980s, Mexico became a veritable test-case of an

outward-oriented, private sector-led economy. Though most developing countries pursue an outward-looking development strategy, the emerging market prototype of outward-orientation implies much more. The centerpiece of this strategy is the liberalization of all markets coupled with the increased dependence on the private sector for the attainment of development objectives. Thus, it envisions a decreased role for government in the development effort.

This strategy, however, reveals an implicit defect in the structure of developing economies. The lack of capacity to mobilize domestic resources makes dependence on foreign capital a dire necessity. Thus, structural adjustment programs (SAPs) are hastily undertaken in order to tap the global capital market, in particular, private voluntary capital. Under this paradigm, the strengthening of the capital market is necessary because it is from this source that the developing economy derives its sustenance.

A comparison of the composition of long-term private flows among selected Asian countries essays this phenomenon. While the Philippine and Mexican[7] economies are driven by portfolio investments, foreign direct investments fuel much of China, Thailand, Indonesia, and Malaysia's growth[8].

"This [liberalization] strategy, however, reveals an implicit defect in the structure of developing economies. The lack of capacity to mobilize domestic resources makes dependence on foreign capital a dire necessity."

The surge in private capital inflows concurs with the larger phenomenon of heavily indebted countries regaining access to voluntary capital flows. However, this is considered as a result of the rapid growth and globalization of the world capital market, the decline of US short-term interest rates, and the slow-down in US and European growth.[9] Arguably, private capital flows, whether from portfolio investments or direct investments, ease the pressure on domestic resource mobilization for growth. Nonetheless, as long as

short-term capital acts as the backbone of an economy, the latter can never withstand the volatility of both the domestic and the international market.

Implicit in these SAPs is the view that inflation rates should be regulated. This is done by implementing tight monetary and fiscal policies. Fiscal surpluses are derived from tax reform programs and the liberal privatization of government corporations. In Mexico, fiscal austerity has created budget surpluses amounting to some 6-7.6 percent of GDP from 1988 to 1991.[18] An overvalued currency is a consequence of the maintenance of tight ceilings on money supply.

This was clearly the case for Mexico last December. This can very well be the case for the Philippines. Although our

Table 4

Philippine Capital Outflows

1986	1987	1988	1989	1990	1991	1992	1993	1994
0.01	0.00	0.01	0.00	0.01	0.00	0.03	0.19	0.07
0.12	0.17	0.19	0.22	0.46	0.23	0.78	2.50	3.47
0.00	0.01	0.00	0.03	0.00	0.03	0.22	1.95	2.39
0.03	0.16	0.04	0.02	0.04	0.06	0.16	[illegible]	[illegible]

Legend:

Investment abroad — Portfolio Investments

Withdrawn from RP — Others

economy is still experiencing a net inflow of capital, there is reason to be wary. Capital outflows increased as portfolio investments abroad and withdrawals from the Philippines grew Table 4.

In this new age of highly mobile capital flows, maintaining an overvalued exchange rate becomes untenable for the following reasons:

1. an overvalued currency implies a bias against exports which, in turn, results in a widening trade gap that necessarily depletes an economy's international reserves;

2. as capital flows out, the country's reserves correspondingly contracts, imposing pressure on the currency; and,

3. since capital can easily transfer from one border to another, the economy becomes sensitive to the volatility of internal and external markets, making exchange rate intervention more burdensome and imposing severe threats to the stability of the macroeconomy.

The issues of a widening trade gap and overdependence on international portfolio capital are intertwined, and a growth path premised on these is based on hollow ground. What is needed, therefore, is a major turn-around in the country's productive capacity. Ironically, both productive and export competitiveness remain idle priorities in the Philippines' development program.[11]

As long as the government sees no urgency and refuses to recognize this connection, believing instead that growth can be achieved under its present development paradigm, another Mexico will always loom in the horizon.

Notes

[1]The drop occurred last January 13, 1995.

[2]See De Dios, Emmanuel and Joel Rocamora (eds.). *Of Bonds and Bondage.* TNI, FDC and PCPS, 1992.

[3]This was partly due to the unbridled privatization of government enterprises.

[4]The Philippines is among those tagged as 'emerging markets.'

[5]Although some also consider the worsening political situation as the main factor in the outflow of dollars. Investors simply refused to come in because of the instability of the political situation. This factor is not discounted.

[6]The volatility band is a measure to ensure mild fluctuations in the Philippine exchange rate. If the exchange rate fluctuates to more than 1.5 percent of the previous day's rate, the Central Bank intervenes.

[7]Both are dubbed as emerging stock markets.

[8]Data from *Financial Flows and the Developing Countries: A World Bank Quarterly*, August 1994.

[9]See Esguerra, Jude and Nepo Malaluan. *Positive Net Inflows Not Necessarily Good Economics.* FDC.

[10]Data from the World Tables 1994.

[11]Specifically, government's austerity is clear in the 1995 Budget. There is no significant shift in the expenditure program; funds allocated for economic and social services remain at low levels.